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United States Circuit Court of Appeals 1335

For the Ninth Circuit

J. P. DUKE, as Supervisor of Banks of the State of Washington, and as Successor in Office of the Defendant CLAUDE P. HAY, as State Bank Commissioner of the State of Washington, FORBES P. HASKELL, JR., as special Deputy Supervisor of Banks of the State of Washington, and SCANDINAVIAN AMERICAN BANK OF TACOMA, a Corporation, Appellants, vs. McCLINTIC-MARSHALL COMPANY, a Corporation, FAR WEST CLAY CO. et al., Appellees.	No. 3953

Brief of Appellees, Far West Clay Co., et al.

UPON APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE WESTERN DISTRICT OF WASHINGTON, SOUTHERN DIVISION.

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STATEMENT OF THE CASE.

This brief is in behalf of the Far West Clay Company and Savage-Scofield Company, who claimed and were allowed mechanics and materialmen's liens on the building and real estate hereinafter de-

scribed, as well as the other lienors, similarly situated, who join formally therein. This embraces all the parties to the suit except the Scandinavian American Bank, the Scandinavian American Building Company, F. P. Haskell, Receiver of the Scandinavian American Building Company, and John P. Duke, Supervisor of Banking, etc.

This suit was brought to foreclose a lien for builders' materials furnished for use in the construction of a building on lots 10, 11 and 12, in block 1003 in Tacoma, Washington. Most of the other parties thereto, by cross-complaint or counter-claim, sought to foreclose laborers' or materialmen's liens on the same property.

John P. Duke, Supervisor of Banking of the State of Washington, in charge of winding up the business of the Scandinavian American Bank of Tacoma, an insolvent bank, was made a defendant in this suit. He appeared and by a cross-complaint sought to foreclose a mortgage on lots 11 and 12 in block 1003 in Tacoma, Washington, two of the lots mentioned above, for about seventy thousand dollars ($70,000) and interest which, shortly prior thereto, had been obtained by him by assignment, from the Penn Mutual Life Insurance Company.

He also sought thereby to foreclose a purchase money lien on the said lots, as well as on lot 10 in in the same block, alleging that the bank sold these lots to the Scandinavian American Building Company and that a lien for the unpaid purchase price thereof arose in favor of the bank.

He also sought thereby to foreclose on all of said lots, a certain mortgage which was given by the building company to one Simpson, securing its note for six hundred thousand dollars ($600,000), which note and mortgage the bank claimed to hold by assignment, as collateral security, for certain alleged indebtedness of the building company to it.

At or about the conclusion of the case Duke practically, but not definitely, withdrew his claim of a purchase money lien and took the position that the amount due for the purchase of the lots, being the principal sum of three hundred and fifty thousand dollars, was in fact embraced in the amount for which the Simpson mortgage was held as collateral, and he asked that this sum be included in the amount of the decree foreclosing the said mortgage.

This is the history of the mortgages and the alleged purchase money lien:

In 1909 the Scandinavian-American Bank bought lots 11 and 12 in block 1003 in the City of Tacoma and occupied the building on them until it was torn down in 1919. The lots were subject to a mortgage for about sixty-five thousand dollars ($65,000), which amount was deducted from the agreed price of $280,000 and the balance, $210,000 or $215,000, was paid in cash (Transcript 1129). The title was taken to an employee of the bank, who afterwards conveyed the property to the bank, and the bank afterwards conveyed it to one Chilberg, an officer of the bank, who thereupon gave a mortgage

on it for a greater sum and then, paying the old mortgage, conveyed the property back to the bank.

The transaction of the conveyance of the property by the bank to Chilberg and the giving of a mortgage by him and the reconveyance of it to the bank, was thereafter several times repeated, until the seventy-thousand-dollar mortgage in question here was given by Chilberg, followed as usual by a reconveyance of the property to the bank. This mortgage was for one hundred thousand dollars ($100,000), but by payments made by the bank was reduced to seventy thousand dollars ($70,000). It will be referred to herein as the seventy-thousand-dollar mortgage.

The mortgages were given by Chilberg, instead of by the bank, so that the debt would not appear as one of its liabilities, but in each instance where the mortgage was increased the bank received the excess and it always paid the interest on the debt and made payments in reduction of it (Transcript 1100-1-2, 1129-30, 1132, 1138-40).

A consideration of the evidence shows conclusively that no matter whether the mortgage did or did not appear as a liability of the bank on the records or in its published reports, so far as this case is concerned, it was the debt of the bank.

In 1919 a scheme was formed, by the bank, for the building of a large office building by it on the three lots, to be the permanent quarters of the bank, and the Scandinavian American Building Company

was formed by the bank, acting through its officers, as the agency through which the scheme was to be carried out. The banking laws of the State of Washington prohibit the investment of more than a small amount of the bank's money in a banking building, hence the effort to indirectly accomplish this result.

Lot 10, known as the "Drury" lot, was then bought and paid for by the bank, the consideration being sixty-five thousand dollars ($65,000), but it was conveyed by the owner directly to the building company. This lot is not embraced in the seventy-thousand-dollar ($70,000) mortgage, but it is included in the Simpson mortgage, hereinbefore referred to.

In furtherance of the scheme, and on February 25, 1920, the bank conveyed lots 11 and 12 to the building company for three hundred and fifty thousand dollars ($350,000), which included the amount it had originally paid in cash for the two lots, the amount of the original mortgage thereon, the price paid for lot 10, the Drury lot, and some items of interest and expense charged against the account. The deed was a warranty deed *with full covenants* (Record, p. 1194). The consideration was a nominal one, but the stamps were $350 in amount.

At or prior to the time of the conveyance of the lots to the building company by the bank, it was expressly understood and agreed between the parties

that the bank assumed and would pay off the seventy-thousand-dollar mortgage (Transcript 1045, 1046-49).

In the fall or summer of 1920 the manager of the bank went East, carrying with him its check to pay off the seventy-thousand-dollar mortgage which it had agreed to pay, but the time of its payment was extended and it was not paid (Transcript 1045-6).

An understanding was had between the bank and the building company that, in order to raise the money to complete the building, a mortgage for six hundred thousand dollars ($600,000) should be given by the building company, and that it should be floated in the East, for which some contingent or conditional arrangement had been or was about to be made. This was to be a first mortgage and it was accordingly executed by the building company to one Simpson, securing a note made by him for that amount. This mortgage, of course, could not be negotiated or become a first mortgage until the seventy thousand dollars ($70,000) was paid off. It will be hereinafter referred to as the "Simpson" mortgage.

Simpson having failed to negotiate this mortgage, the bank president feared that if anything happened to Simpson with the mortgage standing in his name, serious results might follow, and accordingly it was determined by him that Simpson should assign this mortgage to the bank to guard against

such a contingency. An assignment of this mortgage was accordingly taken to the bank for *no other reason or purpose.* Mr. Larson, who obtained the assignment, swore to this (Transcript 1048-51, 1085). It was made in October, 1920, after the lienors had begun to furnish the builders' materials for which they claim liens in this suit.

At some later date when called on to make a showing of its assets, certain officers of the bank stated, or claimed, that it held this mortgage, by virtue of this assignment, as collateral security for the payment of the indebtedness of the building company to it, but when or how or with whom this idea originated is not clearly shown by the evidence. There appears to have been no substantial basis for it.

It was not contended in this suit that the building company consented to or acquiesced in this statement or claim, but it was suggested that the fact that some of the officers of the bank, who assented to or acquiesced in it, were also officers of the building company, was equivalent to its consent. There was, in fact, no indebtedness from the building company to the bank at the time the assignment was taken, or if there was any it was but a small amount. As a matter of fact, one or two officers of the bank testified that Larson, the manager of the bank, said he would obtain the assignment as security for the indebtedness to the bank. This testimony was objected to and the court reserved

his ruling, taking the position that he would consider the testimony if it later appeared that it was material or competent. Mr. Larson was the man who obtained the assignment and he knew why and for what purpose he did it. At that time the scheme of constructing the building was in progress.

If the Simpson mortgage, from which the money to pay for the building was to be derived, had been pledged to the bank, its value for the purpose for which it was given would have been destroyed. Larson's statement must be correct.

As a part of the scheme, it was agreed between the bank and the building company that the latter company would give another mortgage on these lots, to be a *second* mortgage securing bonds for seven hundred and fifty thousand dollars ($750,000), and that the bank would take these bonds to the amount of three hundred and fifty thousand dollars ($350,000) in payment for the said lots, and that the balance of the bonds should be sold to procure money needed in the operations, the Scandinavian American Bank of Seattle, Chilberg's bank, agreeing to take part of them. This mortgage was not executed, the inability of Simpson to negotiate his mortgage and other circumstances having eventually caused the collapse of the entire scheme.

At the trial Duke did not rely wholly on the assignment of this mortgage; he contended that in some way, by virtue of some implied understanding or some equity arising from the circumstances,

this mortgage was security for the money paid out by the bank prior to this assignment as well as that subsequently paid out, and that the security attached at the time of the giving of the mortgage, so as to take priority over the liens for materials and labor subsequently expended on the building.

There is no foundation whatever for the claim that the Simpson mortgage was given to secure any present or future advances of the bank to the building company. The evidence shows that at the time it was made no such advances were then contemplated (Transcript 1084-88, 1153-1177). If any were made, the making of them was in violation of an understanding among the bank officers and the Bank Supervisor that the bank would not advance any money for that purpose, and was but the unwarranted act of the managing officer of the bank (Transcript 1088, 1153-77). If he had any definite plan, he relied, for their repayment, not on the Simpson mortgage, but on the money to be derived from the bonds to be issued under the second mortgage, which was to be given after the placing of the Simpson mortgage. If the advances were not contemplated, when the mortgage was given, how can it be said that the mortgage secured them?

Only a very small amount of money had been advanced by the bank prior to the assignment of the Simpson mortgage. Two hundred thousand dollars of the bank's money was placed to the credit of the building company, but this was in payment for

the subscription of Larson to the capital stock of the building company, which he made for such a purpose, and the stock was turned over to the bank and it became the owner thereof (Transcript 1032-3, 1043). The validity of this transaction does not throw any light on the question whether the mortgage was given to secure an existing debt.

During the last stages of the trial of this suit it was claimed that the purchase price of the lots was secured by this mortgage, yet, by the express agreement just referred to, the bank was to be paid for them by bonds issued under the second mortgage, to which we have just referred (Transcript 122-3, 1017, 1106).

In reality, the bank itself was constructing the building, and while it seems almost incredible that a bank with such limited capital and assets would assume a collateral undertaking involving the expenditure of over a mililon dollars in money and would, in blind confidence and recklessness, expend its actual available cash in furtherance of it, while the scheme itself was still in the formative stage, yet this was done, and the evidence does not render it as probable that the bank expected to be paid its money from the proceeds of the Simpson mortgage as that it expected it to be paid from the proceeds of the bonds to be issued under the second mortgage, mentioned above.

The declaration of trust made by Simpson to the building company clearly shows that the proceeds

of the Simpson mortgage were to be paid to the building company, untrammeled by any claim or trust in favor of the bank (Transcript 1011-12). The transaction presents the aspect of one in which the officers of the respective corporations, largely identical in person, did not deem it necessary that there should be any express or written agreement as to the time or the maner in which the expenditures of the bank should be returned to it. The bank officers seemed to think that the bank could do what it pleased with the money in its possession and that in dealing with the building company it was dealing with itself, or with one wholly within its control or under its direction.

Before the commencement of this suit and after the failure of the bank, the Supervisor of Banking, John P. Duke, who will be hereinafter referred to as "Duke", filed a petition in the State Court alleging that the bank held a mortgage for six hundred thousand dollars ($600,000) on the three lots hereinbefore described, but that there was a first mortgage on two of them for seventy thousand dollars ($70,000); that payment thereof had been demanded and that if it was not paid the interest would be increased to eight per cent. He asked for an order to pay the latter mortgage and take an assignment of it. The court made an order, *ex parte*, in which it recited that the petition sought for an order "to take up by assignment or otherwise" the mortgage in question and that

it was to the interest of the creditors of the bank that it should be *taken up* "to prevent the foreclosure of the same and thereby incurring a tremendous amount of costs and attorneys' fees", and it directed that the mortgage be taken up "by a ssignment or otherwise" by the Bank Supervisor (Transcript 1217). Duke paid the mortgage and took an assignment of it, and is now seeking to foreclose it in this suit, and in his cross-complaint prayed for an attorney's fee of seven thousand dollars ($7,000) for the foreclosure of it.

After having thus obtained this mortgage, and being already the holder of the Simpson mortgage by assignment, which was manifestly subordinate to the liens for builders' material, if it was valid at all in the hands of the bank, and the holders of the liens having begun this action to foreclose the same, Duke determined to use this mortgage for the protection of the bank and its interests, and to squeeze out the holders of the liens if possible, and he sought foreclosure of it for this purpose.

At the trial it was contended by us in behalf of the Far West Clay Company, Savage-Scofield & Company and the other lienors that the payment of the seventy-thousand-dollar mortgage by Duke, the Supervisor of Banking, operated as a discharge of it, and that the assignment to him was of no effect, for the following reasons:

1. That the debt secured by the mortgage was in fact the debt of the bank and the bank was under

a legal obligation to pay it, although the debt was in form the debt of Chilberg.

2. That when the lots were sold to the building company by the bank the amount of the mortgage was not deducted from the consideration agreed on, but it was included in it and the bank *expressly assumed and agreed to pay this mortgage;* that the bank, and hence Duke, could not pay the debt and hold the mortgage in violation of its contract, against the intervening rights and equities of others.

3. That the deed from the bank to the building company, conveying the lots, was a warranty deed with full covenants; that the bank, and hence Duke, could not purchase and hold the mortgage against the mortgaged premises in violation of its warranty against intervening rights and equities.

4. That in this suit Duke was attempting to recover and enforce a lien for the full purchase price of the lots, which included the amount of this mortgage. That he was thus affirming and seeking to enforce the contract in part, while he was repudiating it in other respects by seeking to enforce the mortgage which the bank had agreed to pay and against which it had covenanted.

The court adopted the view that the relation of the Supervisor of Banking to the bank and the other parties was like that of a receiver or similar trustee and that, inasmuch as a payment by the bank in this manner would have operated as a discharge

of the mortgage, the same legal consequences followed when it was paid by Duke. The fact that in his cross-complaint Duke sought the foreclosure of a lien for the purchase price of the lots, and that in this price was included the amount of the mortgage which the bank was bound to pay and which it assumed to pay, and the further fact that even at the conclusion of the trial Duke claimed that the full amount of the purchose price was secured by the Simpson mortgage and asked for a decree therefor, influenced the court in his decision. Foreclosure of the mortgage was denied, as well as the foreclosure of the purchase money lien.

The decision of the court below is reported (Sec. 281 F. 166).

As to the Simpson mortgage, it was contended by us and all the lienors that this mortgage could not be foreclosed by Duke at all and that, in any event, it was subsequent to the liens for labor and materials, for the following reasons:

1. That Simpson held the mortgage as trustee for the building company, for the purposes indicated by his declaration of trust to that effect (Transcript 1010). Therefore he had no power, at the mere request of the bank, to assign it as collateral security. That all the facts were known to the bank and its officers and it was a mere volunteer .

2. That, under this assignment, the bank held the mortgage as trustee for the building company with no better or other title than was the title of Simpson, its assignor.

3. That the mortgage, not having been sold and negotiated and no money having been paid for it, its purpose failed and it was but a lifeless contract, importing no liability to anyone. An assignment of it for some other purpose would not be valid.

4. That it did not appear from the evidence that the building company knew of or consented to this assignment or the alleged purpose, by reason of which the right to enforce it is now claimed.

5. That if the assignment was in fact made as security, the debt was a pre-existing one and, no consideration passing, it and the mortgage were void under the constitution of the State of Washington, which prohibits the issuance of bonds, notes, etc., by a corporation, except for money or property actually received, which has been construed to mean a present consideration.

6. That if the mortgage ever became security to the bank in any way, it was only by virtue of the assignment, and consequently money expended by the bank prior to its execution would not be secured by it or take priority over liens initiated prior to the assignment.

7. That as to advances made by the bank after the assignment of the mortgage, the liens would take priority over it in those cases where the lienors began to furnish the labor and materials prior to the making of these advances.

8. That the officers of the bank had falsely represented to the lienors and had caused it to be gen-

erally understood that the money to pay for the building had been provided or arranged for, and the bank was therefore estopped from subsequently taking as security one of the mortgages which it now appears was given for the purpose of providing this money, and then holding it as collateral security for its advances against the rights of these lienors. That it would be inequitable to permit the bank to do this and it is therefore estopped from so doing.

This is the view of the court below as shown in the opinion, 281 Fed. 181:

The foreclosure of this mortgage was denied because the assignment of it was as collateral security for a pre-existing debt.

The court also held that it would be inequitable to permit the bank to foreclose this mortgage against the lienors, because the money to be derived therefrom was to have been applied to the payment of the expenses of the building operations, the building company being the mere agent or creature of the bank.

ARGUMENT.

$70,000 MORTGAGE.

This suit was begun on January 18, 1921.

The $70,000 mortgage was assigned to Duke on February 25, 1921.

The order authorizing the purchase of it was made on February 23, 1921 (Transcript, page 1217).

At this time the whole matter was in this situation:

The building company was indebted to the bank in quite a large sum of money. It owed the bank for the purchase price of the three lots, which, the amount of this mortgage being included, amounted to $350,000. The bank had no security for the purchase price of the lots, it having been agreed that they were to be paid for by the issuance of bonds secured by the $750,000 mortgage that had never been executed (Transcript 122-3, 1017, 1106).

The bank was the holder, by assignment, of the Simpson mortgage, which it claimed to hold as security for advances to the building company, but which assignment and mortgage were of doubtful validity and effect. Several hundred thousand dollars had actually been expended in the construction of the building by the building company.

The liens of the lienors which have been asserted in this case had already attached and in most cases the notices of liens had been filed. Duke was therefore confronted with this situation:

The time of the extension of the $70,000 mortgage, made to Larson when he took a check to the holder to pay it, had expired and payment was demanded.

The bank was in a position where it could not rescind the contract because the parties could not be placed *in statu quo.*

There is no evidence of any facts which would have justified a rescission because, as clearly ap-

pears, there was never any demand for the execution of the $750,000 mortgage, nor would it have been feasible to carry out that part of the scheme until the Simpson mortgage had first been floated. It appears that the execution of the $750,000 mortgage, and issuance of the bonds to pay for the lots and to enable the bank to recoup its advances, had been lost sight of by the parties, and there was no breach of the contract to execute the mortgage by the building company. Therefore we say that the Bank Suprvisor, for himself or the bank, could not have rescinded the contract for the two reasons indicated.

He could not stand by and permit the $70,000 mortgage to be foreclosed because the bank had warranted the title to the real estate against it, and if, by reason of its foreclosure the building company lost the property, it would have a claim against the bank for damages in a very large sum. It was therefore necessary, in the exercise of common, ordinary business sagacity, for Duke to eliminate this mortgage in some way.

Inasmuch as the bank had assumed the payment of it in consideration of the promise of the building company to pay $350,000 for the lots, it was clearly the duty of Duke, if he intended to claim the purchase price of the lots against the building company or to claim under the $600,000 mortgage which was put on the lots after they had been conveyed by the bank to it, to pay and discharge this mortgage.

The order of the court, which was wholly *ex parte*, authorizing him to do so, clearly indicates that, at the time the order was obtained, Duke expected to pay the mortgage or discharge or take an assignment of it for the protection of the estate, and not for the purpose of speculating on the rights of those who had furnished builders' materials, based on the ownership of the property by the building company, free of all incumbrances.

Duke was not a party to the original complaint and he bought the mortgage before it had been filed.

After the supplemental complaint had been filed and the situation had cleared, it is apparent that Duke realized he had no security for the purchase price of the lots and that the assignment of the Simpson mortgage was of doubtful validity. He thereupon determined to assert the $70,000 mortgage adversely to the rights and equities of all the other parties, against the property, and in this maner to obtain the advantage of a decree for the amount of the mortgage, prior to their liens. The discussion in a more specific way of his right to do this will be presented later in this brief.

At this time we take the position that the order of court authorizing the payment or purchase of the mortgage, taken in connection with the other circumstances which we have set forth, contemplated that the mortgage should be paid to protect the estate, and it appears clear that Duke was acting in violation of the order of the court and in violation

of his duty when he attempted, in this action, to assert the $70,000 mortgage as a prior lien on the two lots covered by it, instead of treating it as paid. Under the circumstances he cannot be heard or permitted to say that, when he took the assignment of this mortgage, he took it for any other than a rightful or lawful purpose, which was to discharge it in accordance with the undertaking of the bank to do so.

In the case of *Sisk v. Rapuano*, 11 A. L. R. 1291 (S. C.), 108 Atl. 858, a somewhat similar situation was presented, except that the trustee in bankruptcy, after taking an assignment of a mortgage, as to which there was a warranty in the deed, assigned it to a third person. The action was brought by the assignee to collect the debt. The court said:

"And the court was fully justified in treating the alleged purchase of the note as a futile attempt to keep the mortgage alive as against the mortgagor and as against the lands in the hands of the mortgagor's grantees."

It also said:

"It is difficult to see why any responsible authority should permit a trustee in bankruptcy to buy an overdue demand note of the bankrupt secured by a mortgage on real estate, the endorsement on the note being 'without recourse and without warranty express or implied', and the surrounding circumstances making it at least probable that the trustee was buying a lawsuit.

"The only reasonable explanation of the affair is that which the court adopted, namely: That the trustees, who might either elect to carry out or not the contracts of the bankrupt, according to whether they seem profitable or otherwise, elected to carry out the contract expressed by the policy, in order to obtain the balance of the insurance money for the estate. Having adopted and elected to carry out the contract expressed in the policy, he is bound to take it as he found it, including the open mortgage clause."

Applying this doctrine to the case at bar, we say that the act of Duke in paying and taking an assignment of this mortgage must be treated as an act, directly in the discharge of his duty, to preserve and protect the estate in his custody by preventing a foreclosure of the mortgage with the resulting loss, to both the building company and the bank, arising from the breach of the warranty.

The court below adopted the same view of the question in this case and said:

"The deed from the bank to the building company being a warranty deed, if the lien claimants were not in privity with the owner, so that they could miantain suit against the bank upon the warranty, the building company and its receiver could maintain such a suit, and anything realized therefrom could be subjected to judgments recovered by the lien claimants. The bank's receiver, in taking up this mortgage, was merely seeking to prevent the

further increase of claims against the trust estate in his hands, which, if suffered, would result in the dilution of the assets, and could not but prejudice the depositors and other creditors of the bank. Under these circumstances, to hold the bank receiver's action in taking up the underlying mortgage a purchase, whereby he escaped liability upon the warranty and also secured a position of advantage where he could defeat the lien claimants, not only has no equity in it, but would be highly inequitable."

McClintic-Marshall Company v. Scandinavian American Building Company, 281 Fed. 166, 170.

What we say in this connection, with reference to the breach of the warranty, applies as well to the breach of the agreement and contract of the bank to pay and discharge this mortgage. We say breach because, if Duke is permitted to enforce this mortgage, it constitutes a breach of this contract.

We may add that in this suit Duke is attempting not only to foreclose this mortgage, but is seeking to recover the full contract price of the lots, $350,000, which includes the mortgage, either as a purchase money lien or under the Simpson mortgage. Our equities entitle us to invoke the rule of equity against it.

The foregoing statement indicates clearly to the court the condition of the estate of the insolvent bank, its claims to the $70,000 mortgage, the $350,000 lien, and the Simpson mortgage; and it clearly lays before the court the rights and equities of

others asising from the valid and subsisting contracts made by the bank in assuming the payment of the $70,000 mortgage and in warranting the title to the real estate, and places the court in a position to properly consider, if necessary, the other questions concerning the right to foreclose the $70,000 mortgage, which we will now present.

IN ANSWER:

In this connection we desire to call the attention of the court to the discussion of this question found in appellant's brief, beginning on page 65, under the heading, "There was no *intention of the Bank Commissioner to pay the mortgage and discharge the lien thereof.*"

How can this be contended in the face of the fact that Duke then expected to enforce his purchase money lien and is now doing so? The assumption of the mortgage was part of the agreement for the purchase of the lots, and the amount thereof was included in the price. Can he be heard to say that his purpose was to hold both the mortgage and the purchase money lien?

In this discussion, while counsel for appellants frankly admit that the doctrine of merger has no application to the case at bar, yet for some reason they enter into an argument on the doctrine. They point out that one of the cardinal rules for the application of the doctrine of merger is that a merger will not be decreed against the intention of the

parties, and they cite a long list of cases to sustain this proposition. We do not dispute this proposition as a general rule, but we submit that there is a qualification of this doctrine which may be expressed in these words:

Whenever the rights of others are involved and justice and equity require it a merger will be decreed, even though it was the intention of the party acquiring the interest or estate subject to merger, that a merger should not take place.

It is idle, however, to talk here about the doctrine of merger applicable to conditions where there are two estates, held by the same person at the same time, which is the condition to which this doctrine is applied. The doctrine that we invoke in this case is not the doctrine of merger; it is a rule of equity or law, as you please to call it, which is applicable to the conditions existing here. It has a certain similarity to the doctrine of merger, but this similarity extends no further than the fact that they are both rules of equity and are established and applied for the purpose of enforcing justice and right.

There is a rule, however, relating to the doctrine of merger, to which — unconsciously, perhaps, — counsel for appellant has called the attention of the court, and this rule should be conclusive as to all the arguments adduced by counsel on this subject. It is found on page 76 of the brief. Speaking there of the question whether a legal obligation

on the part of the purchaser of the encumbrances to pay the same, would prevent him from holding the mortgage as a separate obligation after he had done so, the court said:

"When no such controlling obligation or duty exists, such an assignment shall be held to constitute an extinguishment or an assignment, according to the intent of the parties and their respective interests, and that such will have a strong bearing upon the question of such intent."

Counsel for appellant prefaces this quotation with the remark that *"the bank was under no obligation to pay this mortgage"*. This statement is found on pages 76, 82 and 83 of appellants' brief. It is incorrect.

We desire to call the attention of the court to the fact that, under the evidence in this case, it was conclusively and overwhelmingly established, without contradiction, that the bank assumed and agreed to pay this mortgage as part of the contract by which the building company bought the lots, and that, in addition to this fact, the bank warranted the title to the property against all encumbrances, and this of itself imposed on it the obligation to discharge this mortgage, as we will show by references and by the authorities almost immediately following in this brief. The following may be stated to be the rule on this question, as applied to a state of facts calling for its application:

While it is true that the intention of the party will ordinarily control in determining the question

whether there is a merger of the two estates, yet where one of them consists of a mortgage on the other, and the party purchasing and taking an assignment of it is under a legal obligation to pay and discharge it, the question of intent becomes immaterial and, upon payment and taking the assignment of the mortgage, it becomes extinguished.

This is the general rule that may be deduced from the cases cited by appellant, but it is espcially laid down in the following cases:

Strong v. Converse, 8 Allen 557, (S. C.), 85 Am. Dec. 132;
Brown v. Lapham, 3 Cush. 554;
Jones v. LaMar, 34 Fed. 454.

In the last case it is said:

"It is insisted that he has the same right to recover on this mortgage that the Bank of the Republic would have had. The court does not so understand the law. When a mortgage debt is paid by one who is bound to pay it, an assignment of it to him upon payment operates as a discharge, and he will not be allowed to hold it as a subsisting encumbrance, as the payment was in pursuance of his agreement and duty and may be regarded as being made with mortgagors' money."

This quotation is from page 468 of the reported case, where many cases are cited to sustain the text. This case is too long for us to analyze or discuss, but we invite the atention of the court to it, because

the facts of the case make it decidedly applicable to the case at bar.

It was not questioned in the court below, we believe, that the bank assumed and agreed to pay the $70,000 mortgage. The testimony on this subject, as found in the record, is shown on pages 1045-6 and 1049.

Counsel for appellant, not content with the testimony shown by the record, undertakes to quote from the *transcript of the testimony*, which is not before the court, and in doing so he selects certain portions of it which do not give a fair presentation of the question. We think it is highly improper for counsel to quote this matter, which is not in the record, but we do not know how to meet it except by quoting from the transcript of the testimony, that part which makes clear the truth of our statement on this subject. We quote from the examination of Mr. Larson (Transcript of testimony, page 557):

"DIRECT EXAMINATION.

BY MR. HOLT:

Q. Mr. Larson, calling your attention to the Chilberg mortgage, the Penn Mutual mortgage, about which Mr. Langhorne examined you, the one for which you say that you took the check for the purpose of paying, in the discussion or in the transaction of the sale of the property, lots 11 and 12, by the bank to the building company, who was to pay the Chilberg or Penn Mutual mortgage by virtue of that agreement?

A. The bank was to pay the mortgage.

Q. Then, as I understand it, the building company was to pay $350,000 on the property and the bank was to pay the mortgage that was on it and release it therefrom?

A. Absolutely.

Q. Was that the reason, to relieve that property of the mortgage, that you took the draft to the East?

A. It was due and called, and I told you yesterday, they had only extended it as a personal favor to me.

MR. HOLT: That is all."

What Mr. Larson really meant when he testified in accordance with the quotation found on page 83 of appellant's brief was that the bank expected, when it received from the $600,000 mortgage payment of the amount due to it, from this amount it would pay and discharge the $70,000 mortgage because, of course, it was a mere question with the bank whether the money would be taken out of the proceeds of the Simpson mortgage, when part was paid to it, and the mortgage paid with it, and the building company credited on the books of the bank with this amount, or whether the bank would pay it out of its own funds in the first instance. The testimony of Mr. Larson, shown by the transcript of the testimony on pages 545-6, immediately following that quoted by counsel for appellant, indicates this:

A. "I told Mr. Johnson, the president, and Mr. Steble, assistant to the president,—

Q. Whom?

A. And Mr. Homer, the treasurer of the Penn Mutual Life Insurance Company, that we needed the money until we could get the Metropolitan money and he told me to take the check back and send it back to Tacoma, and I very promptly did, and Mr. Langhorne knows all about these circumstances.

Q. In talking with Mr. E. E. Davis and in talking with Mr. Drury on these matters, it was clearly understood that the $600,000 mortgage would take care of this $70,000 mortgage?

A. Either that or the bank would have to pay it. It was due and called and they simply extended it to me as a personal favor to me more than anything else.

Q. It was the bank's obligation so far as you know?

A. I have so understood it. I did make other payments on that mortgage. The bank got the money on that original mortgage. I satisfied myself of that."

The fact that the bank conveyed the land by warranty deed, intending to pay the mortgage, is strong evidence of its assumption by it. The Simpson mortgage could not be negotiated until it was paid.

We do not desire to spend any further time in reviewing or discussing the authorities presented by appellant on the doctrine of a merger, because we

are satisfied that, if the principles involved in this doctrine have any application to the facts of this case, they sustain entirely the rule for which we are contending and the cases will show it.

EQUITIES OF LEINORS AND BUILDING COMPANY.

EQUITIES OF BANK SUPERVISOR.

Throughout this brief will be frequent references to the "equities of others" and to the "equities of lienors" of the "building company." It is well to define at this point what these equities, in relation to the $70,000 mortgage, are.

At the time the mortgage was assigned, the title to the real estate embraced in it was in the building company, supported by a full warranty deed from the bank and also by the promise of the bank to pay the mortgage. The deed was recorded at or about the time of its execution, which was almost a year prior to the taking of the assignment of the mortgage.

The lienors at that time had valid and subsisting liens on the property, which conferred on them certain legal rights therein. These rights attached to all the right, title and interest of the building company thereto, both legal and equitable, as the title stood at the time their liens accrued by the commencement of the furnishing of the materials or labor.

Each of them could contest the validity of the other liens. They could contest the va lidity of any mortgage on the property, or the right of the holder thereof to enforce the same. They could contest the validity of any other claims asserted against the property.

In support of these legal rights, or by reason thereof, certain equitable rights arose from the circumstances and existed in their favor.

By reason of the assumption of the mortgage by the bank at the time of the sale to the building company, it could not acquire title thereto and assert it against the property, adversely to them. Equity prohibits it from so doing.

By reason of the deed, with a warranty against encumbrances, the bank could not acquire title to the mortgage and enforce it against the property, adversely to their liens. Equity prohibits it.

Even if the failure of the building company to pay the purchase price of the lots would have justified the bank in rescinding the entire contract and thereafter purchasing the mortgage and enforcing it against the building, equity would estop it from doing so against the lienors, on account of the fact that during the time the real estate was the property of the building company under the *warranty deed*, the liens attached. The lienors had, therefore, the right to enforce their liens against it, as the title stood, and equity would estop the bank from buying and enforcing the mortgage against it and would

estop it from rescinding the contract so as to acquire such a right against them. In fact the contract could not have been rescinded under the circumstances, and there has never been any effort to do so. It is being affirmed by an action to foreclose a purchase money lien under the contract.

The lienors had the equitable right to enforce their liens, free from any right of the bank to assert the mortgage it had promised to pay, and against which it had warranted the title.

The lienors also had the equitable right to say to the bank, "You cannot enforce the claim for the purchase price of the lots, which includes the mortgage, and at the same time acquire and enforce the mortgage."

The lienors would have the equitable right to have the mortgage treated as discharged in the hands of the bank, under such circumstances, regardless of the intent or purpose of the bank in acquiring it.

Our position is that these equities are of such a nature that they were binding on Duke when he succeeded the bank. They followed the estate into his hands and he could not relieve it from them, nor could he violate them in administering it.

EQUITIES OF BANK SUPERVISOR.

Throughout the progress of appellant's brief it is constantly contended that some equity in favor of the Bank Supervisor or those whom he represents, superior to the equities of the lienors and the build-

ing company, arises in this case. We dispute this proposition *in toto.* We contend that no equity arises in favor of the Bank Supervisor either from an ethical, legal or equitable standpoint.

The word "equity" as ordinarily used must not be confounded with the "equity" which is recognized by the courts and which calls for their aid and protection. One may have an abstract idea of what would be equitable and just, but it does not follow that this would constitute an equity to be regarded and protected by the courts.

The bank entered into the contract with the building company. It was a foolish contract, but it served as a means by which the lienors in this case were led into the transaction of furnishing the supplies and labor to assist in carrying it out.

The $70,000 mortgage was on the premises and constituted a first lien thereon.

According to the scheme which was adopted and approved by both the building company and the bank a mortgage for $600,000 was given to secure the money to construct the building. This mortgage was given in the spring of 1920, and it was contemplated and expected that it would be immediately negotiated. It follows necessarily that this expectation, as all parties must have known, could not be realized without a previous satisfaction of the $70,000 mortgage.

It was also agreed between the building company and the bank that the building company would pay

$350,000 for the property and that the bank would pay off and discharge the $70,000 mortgage. This agreement seems to have been made in February, 1920, and contemplated that within four months the building company should execute and deliver bonds secured by a second mortgage. In furtherance of the scheme, the bank conveyed the lots covered by the mortgage to the building company by warranty deed, and the deed was put on record. This warranty deed, of itself, was sufficient to advise the lienors and the world at large that the title to the property was free of encumbrances, and necessarily implied that the bank would make good its warranty by discharging the mortgage. The testimony shows conclusively that thereupon the bank and the building company made representations to various lienors and caused it to be understood and induced them to make contracts with the building company and furnish labor and builders' materials.

Now, it is perfectly clear that all parties would have expected that the first step in the execution of the scheme was the release and discharge of the $70,000 mortgage so that the Simpson mortgage might be negotiated, and that after it was negotiated the next step would be the issuance and negotion of the second or $750,000 mortgage from which, when issued, the bank was to receive payment for the lots in the form of bonds for $350,000. We will presume, for the purpose of this argument, that this was a legitimate and business-like transaction.

Later on it developed that the Simpson mortgage could not be negotiated and the $70,000 mortgage became due. Thereupon the president of the bank went East, taking with him a check for the purpose of paying this mortgage, which, of course, was an obstacle to the negotiation of the Simpson mortgage if it was not discharged. An extension of this mortgage was thereupon obtained by the president of the bank.

The plan thereupon became somewhat disorganized by reason of inability to obtain money and, so far as the record in this case shows, it never occurred to anyone that the mortgage for $750,000 should be executed and the bonds issued thereunder in payment of the lots, because the groundwork for this course had not been laid either by the payment of the $70,000 mortgage or the floating of the Simpson mortgage.

It will not do for counsel for appellant to say that the building company was in default with reference to the payment for the lots. The whole scheme became arrested so far as these matters are concerned, and it probably did not occur to anyone that it was even desirable to execute this second mortgage until the $70,000 mortgage had been paid off and the other mortgage had been floated, for if it was not possible to float the Simpson mortgage it would have been absurd to attempt to float the $750,000 mortgage bonds.

There is not a suggestion to be found in the entire record pointing to the fact that anyone ever

even suggested the execution of this $750,000 mortgage so as to pay for the lots by bonds issued under it. As a matter of fact, the bank had not discharged its obligation to pay off the $70,000 mortgage, and the transaction shows that by mutual consent the matter was permitted to rest as it was.

Later on, in September, the bank obtained an assignment of the Simpson mortgage and no effort appears to have been thereafter made to negotiate it.

Under these circumstances it is idle to charge that the building company was in default in respect to the payment for the lots by the issuance of bonds under the $750,000 mortgage. If it was in default in this respect, the bank was also in default in not having discharged the $70,000 mortgage.

It will be observed that the officers of the building company and the officers of the bank were practically identical. It would be a strange thing if they were permitted to put the building company in default under such circumstances so as to affect the equities of the intervening lienors.

The bank failed, and thereupon the problem was presented to Duke whether he would pay off this $70,000 mortgage in pursuance of the undertaking of the bank to do so and in the protection of the bank from the consequences of the breach of its warranty, and in order to protect the estate in its hands from a foreclosure of the mortgage and the consequences which would have followed.

He paid this mortgage from the funds belonging to the estate, which came into his hands for ad-

ministration. It is claimed by appellant that he did not intend to pay it but that he intended to take an assignment of it, keep it alive, and assert it in a hostile manner against the estate conveyed by the bank and in violation of the promise of the bank to pay and discharge it.

When confronted by the legal proposition that such a payment, under the existing circumstances, operated to discharge the mortgage regardless of his intention, he pleads that an equity arose in favor of the estate which he could assert and that it would be a hardship to apply the money of the estate to the satisfaction of this mortgage. Where is the equity to which he alludes? Does it arise from the fact that he made a mistake of law in purchasing this mortgage? Does it arise from the fact that the transaction resulted in a manner different from that which he contemplated?

It is certainly not inequitable to say that the representative of the bank, having paid the mortgage, cannot now claim the benefit of it and assert it against the equities of those who were induced by the bank to make advances to the building company. It is certainly not inequitable for the Bank Supervisor to carry out the contract of the bank for the payment of this mortgage, if he contemplates recovering from the bank the purchase price of the lots. No one can point out how any equity arose in favor of the depositors or creditors, distinct and independent of the equities arising in favor of the Supervisor of Banking.

He stands before this court seeking to foreclose a purchase money lien for $350,000 which he claims arose from the contract of the building company to pay this sum for the property, and we know that this was in consideration of the payment by the bank of the mortgage in question. This lien for the purchase money is being enforced for the benefit of the estate, the depositors and the creditors, and Duke is the agency through which it is being done.

Under such circumstances, to invoke the aid of the court to sustain the right of Duke to put through this grotesque conception seems more like a screaming farce than a serious legal contention. We fail to find the equities referred to by counsel for appellant. On page 33 of appellants' brief is found the statement that there was nothing due to any of the material-men except McClintic-Marshall Co. on October 9, when the assignment was made of the Simpson mortgage. This is not correct. For instance, there was then due or unpaid to the Far West Clay Co. the sume of $976.16 (Transcript 354).

CAN THE SUPERVISOR OF BANKING ENFORCE THE MORTGAGE FOR $70,000, WHICH WAS PAID AND THEN ASSIGNED TO HIM?

In presenting this question it is necessary to discuss it in its two branches separately: (1) Could the bank have paid this mortgage and taken an assignment of it so as to enforce it against the

property? (2) Did the Supervisor of Banking have the right to pay this mortgage and take an assignment of it and enforce it in this suit when the bank could not have done so? The latter question will be presented later in this brief.

The question based on the fact that the debt secured by this mortgage was the debt of the bank, and the other fact that the bank assumed and agreed to pay it in consideration of the promise of the building company to pay $350,000 for the three lots, depend on practically the same rule of law, and they will therefore be discussed together.

The debt secured by the $70,000 mortgage is a continuation of a debt which was secured by a mortgage on lots 11 and 12 when they were purchased by the bank, and the amount of the mortgage was at that time deducted from the purchase price. (Transcript 1129-30).

As we have pointed out, in order to escape the necessity of listing this debt as one of its liabilities, the bank, while paying interest on it and while making additional loans increasing or diminishing it, caused the notes and mortgages to be made by Chilberg, and even went so far as to have a release of it by the holder of the mortgage so that it would not in fact be one of its legal obligations. This was done, apparently, in order to avoid the demand of the banking department of the State of Washington that a true statement of its liabilities should be given; it was finally compelled, we believe, to

publish this debt as a charge against the property of the bank in one of its statements in evidence in this case (Transcript 1100, 1101). It is perfectly clear that while this subterfuge was not adopted to escape the particular consequences connected with the transactions involved in this suit, yet it was none the less a subterfuge; and while it might have relieved the bank from any liability to the holder of the mortgage, yet that is a matter which concerns us very little in this case. We are proceeding against the property, and it would not relieve the property of this charge.

As a matter of fact, Chilberg, the maker of the note and mortgage in question, was not made a party to this suit to foreclose the mortgage, and it is very clear that if the Bank Supervisor had attempted to take a judgment against him for the mortgage debt he would have claimed that it was not his debt but that it was the debt of the bank. If the bank, prior to its failure, had taken an assignment of this mortgage, it is very clear that Chilberg could have defended an action to enforce a personal liability against him for it, on the ground that the debt was the debt of the bank and that it was merely put in the form shown by the record for the convenience of the bank and to relieve it of the obligation of listing this debt as one of its liabilities.

It makes little difference, however, whether the mortgage was in fact the debt of the bank or wheth-

er it merely assumed and agreed to pay it. The rule is the same in both cases:

"Where payment of a mortgage is made by one who is under a legal duty to pay it, the mortgage will be extinguished and discharged, so far as concerns third persons, although an assignment in form may be taken."

20 Am. & Eng. Encyc. (2nd Ed.) 1060; see also 2nd 1027 and 3- b. c.;
Hussey v. Hill, 58 Am. S. R. 789;
27 Cyc. 1332-40, 1435-6-7;
Lydon v. Campbell, 84 N. E. 305;
Lydon v. Campbell, 91 N. E. 151-4;
Clay v. Banks, 71 Ga. 363;
Carrothers v. Stuart, 87 Ind. 424;
Burnham v. Dorr, 72 Md. 198;
Carlton v. Jackson, 121 Mass. 592;
Wadsworth v. Williams, 100 Mass. 126;
Brosseau v. Lowy, 70 N. E. 901;
Butler v. Seward, 10 Allen 466;
Spirk v. Whitten, 31 N. E. 87;
Burch v. Grove, 12 N. E. 514;
Clay v. Morgan, 16 N. E. 790;
Birke v. Abbott, 103 Ind. 8;
Bunch v. Graves, 111 Ind. 353;
Caley v. Morgan, 114 Ind. 357;
Kingsley v. Purdom, 53 Kas. 56, s. c. 35 Pac. Rep. 811;
Burnham v. Dorr, 72 Me. 198;
Danforth v. Briggs, 89 Me. 316, s. c. 36 Atl. 452;

Forthman v. Deters, 69 N. E. 97;
Kneeland v. Moore, 138 Mass. 198;
Jager v. Vollinger, 174 Mass. 521, s. c. 55 N. E. 458;
Frey v. Vanderhoof, 15 Wis. 397.

In the case of *Kingsley v. Purdon*, *supra*, Kingsley sold property on which he had given a mortgage, he having signed the note with his mother, the title to the property being in her name; subsequently a judgment was rendered against the vendee of the property. Kingsley paid off the mortgage but took an assignment of the note and mortgage to a third person. He attempted to obtain priority by foreclosure through this third person over the judgment in this way for the mortgage, claiming that he was only a surety. The court held that he was not a surety and the payment of his own note operated as a satisfaction of it.

In the case of *Burnham v. Dorr*, *supra*, it was held that one having assumed the payment of a mortgage cannot afterwards pay it and keep it alive against the property. There is nothing to show whether the purchaser of the mortgage was still the owner of the property at the time of the purchase, but the circumstances indicate that he was not.

In this case it was also held that notwithstanding the property had been conveyed by warranty deed, yet it was competent to show by parol that the vendee assumed and agreed to pay the mortgage.

In the case of *Danforth v. Briggs, supra,* the title to the real estate was in the wife, the notes were signed by both husband and wife, but the mortgage was given by the wife. The husband paid the mortgage debt and took an assignment to himself. The wife subsequently obtained a release of the mortgage. He claimed he was a surety for his wife. It was held by the court that the evidence showed that the debt was his and the payment by him was a discharge.

In the case of *Kneeland v. Moore, supra,* it was held that payment by one whose duty it is to pay discharges the mortgage.

This was an attempt to shut out the holder of an easement by the person who assumed to pay the mortgage. In this case the court held that it was not a question of merger, but that it was a question of the rights of the parties arising from the circumstances and of their legal effect.

In the case of *Frey v. Vanderhoof, supra,* a man bargained for certain land and agreed to pay a mortgage that was then an encumbrance on it. He caused the title to be put in the name of his son and the son gave a mortgage for the balance due on the purchase price. The vendor foreclosed this mortgage and bought in the property. The man who had bargained for the land and had assumed to pay the mortgage on it then paid this mortgage and took an assignment of it to himself and undertook to assert it against the purchaser and under

the second mortgage. It was held that he could not do so; that the payment by him of the mortgage which he had assumed to pay amounted to an extinguishment of it. The deed by the original vendor contained a covenant against encumbrances, but it is shown by parol that this was a mistake, that as a matter of fact it was the understanding that the vendee should assume the mortgage. It was held that this evidence was permissible.

In the case of *Frothman v. Deters, supra,* it was held that equity did not prevent a merger as against the interest of the third parties, and in this case the question as to what amounts to an assumption of the debt is discussed and should be read.

Lyndon v. Campbell, supra, is a case where it is held that the assumption of the mortgage made it the debt of the person assuming it.

In the case of *Tefft v. Munson,* 57 N. Y. 97, a mortgage was given on land to which the mortgagor had not title. He afterwards acquired a title. It is held that it inured to the benefit of the mortgagee.

In the case of *Sisk v. Rapuano,* 11 A. L. R. 1291, s. c. 108 Atl. 858, there was an insurance policy with a mortgage clause protecting the interests of the mortgagee. There was a fire. After the fire, the owner sold the property and agreed to pay off the mortgage. He became insolvent. His trustee took possession of his estate, which consisted only of the proceeds of the insurance policy. He took

the money, paid part of it to the holder of the mortgage and took an assignment of the mortgage to him. He subsequently sold this mortgage for a nominal consideration to Sisk, the plaintiff in the action, who brought an action to foreclose it against the owner of the property.

Without discussing, at this point, the question as to the right of the trustee to deal with the mortgage as an independent purchaser thereof, the court disposed of the right which the insolvent himself would have had by saying:

"In this case, however, Grillo (the mortgagor and vendor) warranted the land free from all encumbrances and undertook that the mortgage debt should be paid out of the insurance, and it is apparent that Grillo, at least, was not equitably entitled to subrogation."

This case discusses also the question as to the right of the trustee to purchase independently of the right of his principal, and we will refer to it in this brief on this question in the proper place.

Where one assumes the payment of a debt he becomes the principal debtor.

Beitel v. Dobbin, 44 S. W. 299;

Birke v. Abbott, 103 Ind. 1, s. c. 53 Am. R. 474;

Forthman v. Deters, 69 N. E. 97.

The doctrine laid down in the foregoing cases, for which we contend, is sustained by all of the decisions which have come under our notice.

wards pays off or takes an assignment of the mortgage against the premises, the same becomes extinguished. He cannot keep it alive as a subsisting lien, for to do so would be a direct violation of his covenant, which rule is supported by ample authorities there cited."

We believe that it is not necessary for us to cite additional cases to the court supporting this rule. In our investigation of the authorities, we have not found a case affirming a contrary doctrine.

IN ANSWER:

On page 83 of appellant's brief, he takes the position that the bank could have purchased and enforced the \$70,000 mortgage because "it was not liable to pay the same", and because the building company had "breached its contract to pay for the lots".

We have shown in this brief, by reference to the testimony both in the transcript and the record, that the bank not only warranted the title to the lots, but expressly assumed the mortgage, and counsel's statement to the contrary is wholly unwarranted. The Penn. Mutual Co. at one time released the bank from liability to it on the mortgage, but that did not affect its agreement with the building company to pay it. We have pointed out in the preceding pages that the building company did not breach its contract to pay for the lots by the issuance of the bonds under the mortgage; that the

bank did not pay the mortgage and the building company did not issue the bonds because the scheme became paralyzed and everything "went to pot".

In view of the authorities we have cited in this brief, we think no further argument on this proposition is necessary, except to call attention to the fact that in one part of it counsel still insists that the Bank Supervisor "does not stand in the shoes of the bank nor does he represent either the bank or its stockholders". By a strange coincidence, this is just the opposite of the language found in so many of the cases to which we have referred the court, and particularly in the case of *Peoples State Bank of Lakota vs. Frances et al.*, 79 N. W. 853, in which, speaking of the receiver of a national bank, the court said:

"The Government places him in charge of one of its financial agencies for the purpose of closing it up and terminating such agency, and in so doing he simply acts in lieu of the officers of the bank. He replaces them, *stands in exactly their shoes*, so far as the assets are concerned, and their knowledge necessarily becomes his knowledge."

We will not pursue this argument any further.

On page 86 of appellant's brief it is stated that "if the bank itself had paid this mortgage, it would have been subrogated," etc.

Of course this statement is in direct conflict with the authorities, to which we have referred the court, holding that the bank could not purchase or enforce

the mortgage under the existing circumstances. The idea of subrogation is not seriously entertained by appellant. Subrogation is an equitable remedy, which only arises from considerations of justice and equity, and it never is recognized so as to interfere with intervening rights of others. It will not be decreed against a superior or equal equity.

"Subrogation takes place only when one has performed the obligation of another or has paid his own debt, the burden of which has for a consideration been assumed by another, or when he has paid encumbrances for the protection of his own title, the payment of which he has not assumed by contract. The debtor, on whom rests the ultimate obligation of discharging the debt, cannot, by his payment, acquire any right of subrogation". Sheldon Subrogation 46, 2 Pomeroy Eq. Jur. 797.

To decree subrogation, equity will not interfere with intervening rights of encumbrances. It will not be decreed against superior or equal equities.

That the results are different from what was anticipated makes no difference.

Kleimann vs. Giesselman, 35 Am. St. R. 761.

When subrogation is decreed it must be in accordance with some principle of equity which operates in connection with the justice of the case to give the right of subrogation.

Bohn vs. Kennedy, 60 N. W. 579;
Meeker vs. Larson, 90 N. W. 958.

The case last cited contains a full discussion of the subject.

Mistake of law will not create a right of subrogation.

> *Meeker vs. Larson*, 90 N. W. 958;
> *Kleimann vs. Giesselman*, 35 Am. St. Rep. 761, and note;
> 20 Am. and Eng. Encyc., page 816.

The cases cited by counsel on this subject have no application. They are cases in which the vendee assumed the payment of the mortgage, but, having failed to do it, the vendor was compelled to pay the mortgage, his debt, for his own protection.

The cases hold that, under such circumstances, he is subrogated and may foreclose the mortgage against the estate in the hands of his vendee, but this is only in those cases where no intervening equities have arisen. We submit to the court that the cases of this character cited by appellant have not the remotest application to the case at bar.

On page 88 of respondent's brief is found an argument to the effect "that the equities of the lien claimants, being in no way altered by the purchase of the money, it can be enforced."

The cases holding that the man who assumed the mortgage, or who warranted the title against it, could not afterwards purchase the mortgage and hold it against the estate and the intervening rights of third persons, are all cases, perhaps, that present

the same feature exhibited by this case, to which counsel alludes. It is true that if the mortgage had not been purchased, it could have been foreclosed by the Penn Mutual Insurance Company, the holder thereof, but what has that proposition to do with the question? The rules of law and equity prohibit the purchase and enforcement of a mortgage under such circumstances. Is it any answer to that rule to say if the mortgage had not been purchased by the Bank Supervisor it could have been foreclosed by someone else; that therefore the parties in interest are not injured and the rule does not apply? It seems absurd. On the contrary the parties were not left in the same situation when the Bank Supervisor purchased the mortgage. They had the promise of the bank to pay and discharge it, and now, when the bank, through its representative, not only fails to do so, but purchases and undertakes to enforce it, the court will not tolerate an answer which merely states in effect: "Well, if I hadn't foreclosed this mortgage, the holder would have done so. Therefore, you are not injured and therefore you have no right to complain because I purchased it instead of paying it."

The intervening third persons, and the building company as well, are injured. Instend of having the mortgage discharged, it is sought to be enforced against them and the estate as a liability. The equity of the lienors under such circumstances is apparent.

The application of the rule that he who assumes the payment of the mortgage, under such circumstances, cannot take it and enforce an assignment of it, does not depend on whether the parties are placed in any worse position by his buying it than they would be if he let it alone. It depends on considerations of equity which prevent him from doing it.

IF THE BANK ITSELF COULD NOT HAVE TAKEN AN ASSIGNMENT OF THE $70,000 MORTGAGE SO AS TO ENFORCE IT AGAINST THE PROPERTY, COULD THE SUPERVISOR OF BANKING DO SO?

The proposition stated above may be expressed in this form:

If the rules of equity prohibited the bank from purchasing and aserting this mortgage because such a course would be a violation of the equities of others entitled to the protection of these courts, did the Supervisor of Banking occupy a relation to the trust estate and to those interested in it which would permit him to take that course?

The Supervisor of Banking was acting under the authority of the laws of the State of Washington, and his duties and powers are briefly defined in this statute in the following words:

"Upon taking possession of any bank or trust company, the examiner shall proceed to collect the assets thereof and to preserve, administer and liqui-

date the business and assets of such corporation. With the approval of the Superior Court of the county in which such corporation is located, he may sell, compound or compromise bad or doubtful debts and, upon such terms as the court shall direct, sell all real estate and personal property of such corporation."

Session Laws of 1917, 271;
2 Rem. Compiled St. of Washington (1922) § 3269.

The foregoing provision contains all of the statute referred to which affects the question we are now presenting. An examination of it shows its very general character. There are no suggestions in it as to the manner in which his duties shall be performed, and it is only by reference to a subsequent provision of the law that we infer from it that his duty is to pay off the creditors and depositors and then to deal with the residue of the estate, for the benefit of the stockholders, in the manner pointed out by the statute. The language is not unlike that which is found in decrees appointing receivers or administrators.

It is not to be concluded, however, from the absence of specific provisions on the subject, that the Supervisor of Banking is in any sense an autocrat, at liberty to administer the estate in an arbitrary manner. On the contrary, applying the rule that is applied in analogous situations, we know that

the meaning of the statute in question is, that the estate shall be administered in accordance with the existing law on the subject, and, in the absence of any statutory provisions controlling this question, we know the statute contemplated that he should administer the estate in accordance with the common law of the land. To make the statement more accurate, it was his duty, in the absence of specific directions in the statute itself, to administer the estate in accordance with the general law regulating and defining the duties of those who hold the same positions, or positions analogous in law to the one in question.

The building company itself and the lienors, having acquired liens on the property while the title thereto stood in the name of the building company, under a warranty deed to which was added an assumption by the bank of the mortgage in question, had certain equities which a receiver of any character was bound to respect in his administration of the estate.

"The general rule is that a receiver takes the property of which he has been appointed in the same plight and condition and subject to the same equities and liens as he finds in the hands of the person or corporation out of whose possession it is taken."

34 Cyc. 103.

"A receiver holds the property coming into his hands by the same right and title as the person for

whose property he is receiver, subject to liens, priorities and equities existing at the time of his appointment. He becomes merely the assignee of the insolvent and has exactly the same rights."

23 R. C. L. 56.

To the same effect see:

23 R. C. L. (Receivers) 360;
Ryder v. Ryder, 32 Atl. 919;
7 Corpus Juris 735, Sec. 502;
Arnold v. Wiener, 58 N. W. 709-12;
5 Cyc. 560;
New Jersey So. Ry. Co. v. R. R. Comrs. 41 N. J. L. 235;
Citizens Bank v. Kretschmaur, 44 So. 930-2.

"Assignees, trustees in bankruptcy and receivers are not purchasers for value but take the estate of the insolvent subject to all set-offs, liens in encumbrances and in the plight existing at the date to which his title is ultimately referred."

Nix v. Ellis, 45 S. E. 404.

"We understand it to be the established doctrine both in England and in this country, that assignees in insolvency or bankruptcy, whose rights as representing the general creditors are certainly as great as those of a receiver of a partnership, in the absence of fraud and statutory regulations, take only the debtors' rights and consequently are affected with all claims, liens and equities which would affect the debtor if he himself were asserting his interest in the property."

Lawson v. Warren, 124 Pac. 46.

"His (the receiver's) title to the property of the debtor is exactly the same as the title of the debtor himself at the moment when it goes into the receiver's hands."

Miller v. Savage, 60 N. J. Eq. 204, 4 Atl. 652.

"It is insisted that the assets of the bank existing at the time of the act of insolvency included all its property without regard to any existing liens thereon or set-offs thereto. We do not regard this position as tenable. Undoubtedly, any disposition by a national bank, being insolvent or contemplative of insolvency, of its choses in action, securities, or other assets, made to prevent their application to the payment of its circulating notes, or to prefer one creditor to another, is forbidden; but liens, equities, or rights arising by express agreement, or implied from the nature of the dealings between the parties, or by operation of law, prior to insolvency and not in contemplation thereof, are not invalidated."

Scott v. Armstrong (U. S.) 36 L. Ed. 1059.
Beach on Receivers, Alderson's Ed., Sec. 667, p. 718;
Hyde v. Linde, 4 Comstock, 387-92;
Howe v. Harding, 76 Texas 17;
Jordan v. Harris, 135 S. W. 830;
Montgomery B. & T. Co. v. Walker, 61 So. 951;
Cutler v. Fry, 240 Fed. 238;

Brady et al. v. Cobbs et al., 211 S. W. 802;
Finley v. Young, 210 S. W. 143;
Realization Co. v. Roth, 166 N. Y. S. 388;
23 Am. & Eng. Encyc. 1062;
Hamor v. Taylor Rice Eng. Co., 84 Fed. 392;
Gillette v. Moody, 3 N. Y. 479;
Atty. Gen. v. Guardian Mut. L. Ins. Co., 77 N. Y. 272.

Authorities sustaining the foregoing proposition might be cited without number, and we take it that the cases cited thoroughly establish the proposition that, when Duke took possession of the assets of the Scandinavian American Bank, he took the property subject to all the rights and equities of others lawfully created, and the same may be said of his position when he succeeded to the rights of the bank to the balance due for the purchase money of the lots; and when he took the mortgage for $600,000 he took it subject to the equities of others affecting the property embraced within it and affecting its validity; and when he sought to enforce the rights of the bank against the property in question, his right to do so was subject to the valid and subsisting equities of the building company and the lienors. He could not occupy a higher position or one more free of these responsibilities than could the bank itself.

In addition to this, when he attempted to assert the $70,000 mortgage against the property in question, in violation of the warranty of the bank and its agreement to pay the same, he could not enforce

it, freed of the equities of those whose rights had attached, to have the mortgage cancelled and discharged and to have it so treated in this manner.

IN ANSWER:

In this connection we desire to call the attention of the court to the argument of appellant which is opposed to the foregoing argument by us, and which is found on pages 47 to 65, under the headings, "*The Bank Comimssioner was not an Agent of the Bank*", *and "Haskell was an Officer of the State of Washington.*"

We will not attempt to follow in detail this argument, nor will we attempt to answer or criticize the authorities contained in it. Both the argument and the authorities are directed to what may properly be called an immaterial aspect of the question.

It is not a matter of much importance in this case whether Duke was an agent of the bank. We have not contended that he was, and we do not dispute that Haskell was an officer of the State of Washington. Both of these propositions, in certain aspects, are admitted, but what have they to do with the question of the manner in which Duke and Haskell were required to administer the assets and estate of the bank? Various and sundry authorities are collected together in this argument which settle many questions arising under the various statutes creating the officers under consideration.

It may be conceded, as was laid down in one of the cases, that the bank commissioner or examiner,

or whatever he may be called, had the power to levy an assessment, without applying to a court of equity to authorize it. This and the other questions presented in these cases depended on the express or implied powers derived from the language of the statute creating the office. With these powers we have nothing to do.

It will be observed, however, that among all the cases cited by appellant in this argument there is not one which discusses the question how and in what manner the Bank Supervisor or examiner shall deal with the property and estate in his hands or to what extent he is charged with the duty of recognizing and respecting the equities of others. This is the question involved in this case, but the cases cited by appellant throw no light on it whatever.

We have not contended that Duke was acting as a receiver appointed by a court, nor have we questioned any of the powers conferred upon him by the statute of the State of Washington to which we have referred the court.

Counsel for appellant, however, on page 48 of their brief, impliedly intimate that the Supreme Court of the State of Washington has decided adversely to our contention, which is, that in the absence of any clear expression or definition in the statute itself of the manner in which the estate should be administered, the law required it to be

done in accordance with the rules and practice applicable to analogous situations. On the contrary, however, our foregoing statement is the law of the State of Washington.

In the case of *Moore vs. Am. Sav. Bank & T. Co.*, 111 Wash. 148, 158, the court used this language:

"The insolvency of the bank and the taking possession by the examiner could not destroy nor affect this lien. He would take possession of the bank subject to all equities and rights existing in any one else. In 34 Cyc. at page 193, it is said:

'The general rule is that a receiver takes the property of which he has been appointed in the same plight and condition and subject to the same equities and liens as he finds it in the hands of the person or corporation out of whose possession it is taken.'

"In 23 R. C. L., at page 56, it is said:

'A receiver holds the property coming into his hands by the same right and title as the person for whose property he is receiver, subject to liens, priorities, and equities existing at the time of his appointment. He becomes merely the assignee of the insolvent, and has exactly the same rights.' "

This, we think, is a very clear statement by the Supreme Court of this State in construing the banking act, that in the administration of the estate, with respect to matters such as are involved in this case, the Supervisor of Banking is governed by the

substantive law relating to the rights and duties of receivers.

We believe that the rule laid down in this case, being one construing a statute of this state, is controlling on this court.

In the case of *People's State Bank of Lakota vs. Francis et al.*, 79 N. W. 853, the court said:

"It would, we think, be a surprising holding to declare that a receiver of a bank could enforce all unmatured commercial paper that he found among the bank assets, irrespective of the equities existing against such paper. And yet that must logically follow, if the knowledge of the bank is not to be imputed to the receiver. The fact is the receiver of a national bank is neither an indorsee nor an assignee for value. He is simply an agent and officer of the United States. *Ex parte Chetwood*, 165 U. S. 456, 17 Sup. Ct. 385, and cases cited. The government places him in charge of one of its financial agencies for the purpose of closing it up and terminating such agency, and in so doing he simply acts in lieu of the officers of the bank. He replaces them, stands in exactly their shoes, so far as the assets are concerned, and their knowledge necessarily becomes his knowledge. It follows, therefore, that whatever the receiver did, by way of extending time of paymnet, was done with full knowledge that Mrs. Francis was surety only."

It will be observed that in his argument appellant, while pointing out various aspects of the rights and

powers of bank examiners and supervisors derived from the statute, and their affirmance in these cases, nowhere, in express terms, disputes the proposition, either by reason or by authority, that in the absence of controlling provisions in the statute the bank supervisor or examiner is controlled by the law relating to receivers or assignees in insolvency or bankruptcy, or officers acting in analogous positions. If the statute relating to the subject is silent with respect to these duties and powers, then what is the law that regulates them? Counsel has not made a suggestion to the court on this subject. He surely does not intend to take the position that the bank supervisor or examiner is not controlled by some law. He is not an autocrat.

It is not within the province of the Legislature to write into each and every one of its acts all the law pertaining to the subject. Certain general phrases or terms are used which indicate that branch or department of the law which will control the situations created by the legislative act. It is a rare thing, indeed, that in the creation of an office the Legislature should undertake to write all the law pertaining to it into the body of the act itself. The rule is, in the absence of express provisions, that the law applicable to analogous situations is the law applicable to the one under consideration; otherwise there would frequently be no law on a subject.

We must conclude that, regardless of the question whether Duke was an agent of the bank and whether Haskell was an officer of the state, inasmuch as the Legislature in passing the Banking Act was silent on the questions of their duties under the situations and circumstances presented by this case, there is some law of the land which controls, restrains and directs them and all the cases to which we will hereafter refer the court, as well as the decision of the Supreme Court of the State of Washington, to which we have referred the court, clearly indicate that the law applicable to analogous situations prevails, and that is the law applicable to receivers, assignees, etc.

We need not pursue this argument any further.

THE SUPERVISOR OF BANKING IS ATTEMPTING IN THIS ACTION TO ENFORCE THE CONTRACT OF THE BANK IN PART AND TO REPUDIATE IT IN PART. CAN HE DO SO?

It has been demonstrated that the bank assumed and agreed to pay the mortgage for $70,000, in consideration of the payment by the building company of $350,000 for the lots covered by it (Transcript 1129-1132, 1237).

It has been shown also that the bank warranted that the property in question was free from all encumbrances.

It also appears that the Simpson mortgage was given by the building company after the conveyance

of the property to it by the bank and that it purports to be a first mortgage.

Duke, in his complaint in this action, sought to foreclose the $70,000 mortgage and to enforce a purchase money lien for the $350,000, the purchase price of the lots, and to foreclose the Simpson mortgage for $600,000, although he subsequently apparently abandoned his theory of a lien for the purchase money and seemed to take the position that the $350,000 was secured by the Simpson mortgage. What his position will be in this court on the subject we are not now advised. He is thus in the attitude of seeking to recover for the contract price of the lots and on the mortgage in question, while he is repudiating that part of the contract which bound the bank to pay this mortgage; he is repudiating the warranty in the deed, which has the same legal effect in this court; he is seeking to enforce the $600,000 mortgage given on the lots after the conveyance of them by the bank to the building company.

He cannot affirm the contract in part and repudiate it in part. He cannot derive the benefit of it and refuse to be bound by the burdens and obligations contained in it. No principle or rule is better settled than this.

It is optional with a receiver to perform the executory contracts of his principal. If, however, he does elect to perform an executory contract, he cannot perform it in part and repudiate it in part; nor

can he escape from the legal rights of the parties which necessarily flow from his performance.

23 R. C. L. (Receivers), Sec. 80;
Howe v. Harding, 13 S. W. 41.

See, specially,

Com. Pub. Co. v. Beckwith, 60 N. E. 642;
Cent. Trust Co. v. Ohio Ont. R. Co., 23 Fed. 306;
Ann. Cas. 1912 C. 950;
Spencer v. Wob. Col. Exp. 45 N. E. 250;
Clyde et al. v. Richmond & D. R. Co. et al., 63 Fed. 21;
Citizens' Bank v. Kretschmaur, 44 So. 930-2;
Howe v. Harding, 76 Texas 17 (S. C.) 13 S. W. 41.

In the case of *Howe v. Harding*, cited above, it is said:

"If appellant, after making known to the court that appointed him, that the contract proved had been made before his appointment, had asked that he be permitted to use the right of way, but that he be relieved from paying for it in accordance with the contract, that court would not, and legally could not, have given such permission without at the same time requiring appellant to make the compensation agreed upon for the right of way which the receiver necessarily had to use or acquire another to preserve the continuity of the line."

In the same case the court said:

"It is also erroneous to assert that a court appointing a receiver is under no obligation to continue in force, and in some cases to cause to be fulfilled, the personal contracts of the company, though they may have been improvidently made. The continuance of the obligation of contract is not dependent on the will or act of a court, nor can the court in any proper case refuse to execute them."

This case was afterwards again before the court and is reported in 84 Texas, page 75, and it was held that the receiver was bound to pay the stipulated sum for water so long as it used the right of way.

The question was somewhat fully presented to the Supreme Court of the State of Washington in the case of

Crawford v. Gordon, 88 Wash. 553.

In this case it seems that a receiver had been appointed in the State Court for a railroad, but subsequently the Federal Court appointed a receiver of the same property. The Federal receiver bought a number of cars at an agreed price and made a partial payment therefor and certain equipment bonds were issued for the deferred payments. The cars had been sold under a conditional sale contract reserving title in the vendors. The Federal Court made an order quashing all the proceedings and declared that it had no jurisdiction, and it especially quashed the order authorizing the purchase of the cars. Thereupon the property passed into the hands

of the receivers in the State Court. A controversy arose between them and the vendors of the property. The question seems to have come up in a peculiar way, but the lower court held that the bonds issued by the Federal receiver were void, and refused to permit the owner to prove the reasonable value of the cars unless he would release all claims under the equipment agreement or contract of sale. The court held that when the receiver in the State Court took the property and commenced to use it, it ratified and affirmed the contract of sale made with the preceding receiver. They held that the receiver could not repudiate the contract made by his predecessor, and they also held that under the facts in the case, that the receiver did not repudiate the contract, but affirmed it, he was bound to carry it out according to the terms thereof. The court also said that the obligation rested on the receiver to determine, within a reasonable time, whether he would deny or affirm the contract and that his conduct amounted to an affirmance.

In the case of *In re DeLong Furniture Co.*, 188 Fed. 686, there was an assignment of a debt by the furniture company to the bank. Insolvency and bankruptcy of the debtor intervened while the contracts upon which the payment of the money depended were still executory. Apparently the receiver and trustee carried out the contracts and received the money but refused to pay it to the bank. The court said that inasmuch as they elected to

carry out the contract, they stepped into the furniture company's shoes and became bound to devote the proceeds to the object agreed upon.

A receiver cannot abrogate or annul existing contracts of his principal. His power in respect to them is limited to a refusal to carry them out or to a performance of them.

> 23 R. C. L. (Receivers), Sec. 80;
> Ann. Cas. 1912 C. 950;
> *Hyde v. Lynde*, 47 N. Y. 387;
> *Wolf v. McNulta et al.*, 52 N. E. 896;
> *Chem. National Bank v. Hartford Dep. Co.*, 41 N. E. 225.

The mortgage purchased by the bank supervisor secured the debt of the bank. In addition to this fact, the bank had expressly assumed and agreed to pay this debt. In addition to this fact, it had conveyed the land by warranty deed and before the bank supervisor paid the mortgage the liens of the defendants had attached. In addition to all these facts, the bank, through its officers, had encouraged and persuaded the Far West Clay Company and other defendants to advance material for the construction of the building, and, in addition to the foregoing facts, the bank was still in one sense the owner of the real estate. In addition to the foregoing facts, the amount of the mortgage was included in the purchase price of the land. In addition to the foregoing facts, the Bank Supervisor is

seeking, in this case, to enforce a lien or claim against the property for the purchase price of the lots, which includes the amount of this mortgage. It was optional with the Bank Supervisor to pay this mortgage or to let it stand. The contract of his principal was to pay it, and, as we have seen by the authorities cited, if it had been done by the bank itself the payment would of necessity have discharged the encumbrance, and for various reasons the bank would not have been permitted to assert it as a lien on the property, particularly against the equities of the lienholders created and existing by the connivance and persuasion of the bank itself.

Under such circumstances, could the Bank Supervisor pay the mortgage and at the same time escape the legal consequences of his doing so? Was not the payment an election on his part to perform the contract of his principals? Can he be heard to say that it was not, when it appears in this action he is seeking to recover the purchase price of the land, which embraces the amount of the mortgage? It is not within the power or province of the individual to determine under all circumstances what is the legal character and nature of his acts and what is the result that flows from them. A man cannot pay his own debt, for which he is primarily liable, and take an assignment of it to himself or to another for him and then claim that he did not intend to pay it. The law declares that it was a payment under such circumstances. It does not

leave to him the right to determine the legal effect of his act.

At the time of the payment of the Penn Mutual mortgage, the bank held, or claimed to hold, a purchase money lien on the property in question and also a mortgage. We do not question the right of the Bank Supervisor to pay the Penn Mutual mortgage for the protection of the other liens held by the bank. It was optional with the Bank Supervisor to pay this mortgage or to leave its holders their legal remedies. If the Penn Mutual mortgage had not been the debt of the bank, and if it was not in any way estopped from asserting it against intervening liens and equities, the bank supervisor would have the right and the power not only to pay the mortgage, but the power also to take an assignment of it for the purpose of protecting its mortgage against the intervening rights, liens and equities of others. Under such circumstances, if the bank bought the mortgage without taking an assignment, it might be subrogated to the rights of the assignor, and in this way the mortgage might be used to protect the liens of the bank against the intervening encumbrance. The Bank Supervisor exercised his option to pay the mortgage debt, but he now claims that he did not in fact pay it, but that he took an assignment of it. The taking of an assignment, instead of satisfying the mortgage, can be ascribed to only one purpose — the assignment was taken for the purpose of using the mort-

gage against the intervening liens and equities. If the purpose in paying the mortgage had merely been to protect the subsequent liens of the bank against enforcement, this purpose would have been fully subserved by the payment and discharge of the mortgage. Then it would have been no longer asserted as a legal claim to conflict with the subsequent encumbrances held by the bank and others. The purchase of the mortgage by the Bank Supervisor and the holding of it by him under the assignment, instead of a discharge and satisfaction of it, was an annulment and violation by the Bank Supervisor of the contract of the bank with respect to this debt.

As we have pointed out, it was optional with the Bank Supervisor to carry out the executory contract to pay the debt, but it was not in his power to annul the contract or to do an act which amounted to a violation of it and thus to annul it. There is a broad distinction between a refusal to execute an executory contract and the performance of an act which is in violation of it. Does the fact that the building company was in default of the payment of the purchase money justify the Bank Supervisor in not only refusing to carry out the contract for the payment of the debt, but in taking a course of action which could only be justified on the theory that the contract of the bank to pay the debt was no longer binding or obligatory on any one, and that it had become a nullity? So long as the promise to

pay the debt was an existing legal obligation, which had not been cancelled or abrogated by the acts of those who were entitled to do so, the Bank Supervisor was limited in his dealings with the mortgage to a mere payment of the same. The cancellation or abrogation of the contract could only have been accomplished by what in law is denominated a "rescission" of it. That there was no actual rescission by the consent of the parties is clear. Could the bank have rescinded the contract when the only ground for a rescission, so far as the record shows, is the failure of the building company to pay the purchase price?

The contract between the bank and the building company was a very simple one. The bank sold the property to the building company for a fixed consideration. The building company agreed to secure the payment of the purchase price by certain bonds secured in turn by a second mortgage. It is now claimed that the second mortgage was not given in accordance with the terms of the contract. So far as the record shows, the failure of the building company to give the mortgage constitutes the only seeming breach of the contract on its part. There was a failure, but no default. The bank did not pay the mortgage either. It was to be paid first. The Bank Supervisor is in the unfortunate attitude in this action of seeking to enforce its alleged claim for the purchase price of the land, accruing by virtue of the contract in question, and by this act he

affirms the existence of the contract and seeks to derive the benefit accruing therefrom. Under such circumstances, can he be heard to say: "I do not repudiate the contract for the purchase price — I affirm it; but I do repudiate or rescind the contract by which the bank bound itself to pay the Penn Mutual mortgage in consideration of the agreement by the building company to pay this agreed price".

Under some circumstances, a party to a contract has the right to elect whether he will rescind and disaffirm the contract and bring an action to enforce his rights in accordance therewith, or whether he will treat the contract as an existing one and bring an action for its breach.

It is an elementary rule of law that where a party is placed in such a situation, when he makes an election, he is concluded by it, and he cannot maintain an action on one theory and then abandon it or seek to enforce it on another; and it is equally well settled, and it follows as a corollary from the main proposition which I have stated, that in the same action he cannot seek relief which is based on an affirmance of the contract and at the same time seek other relief which is based on a disaffirmance or a rescission of it. The authorities on this question are too unanimous and the proposition is too well sustained to require any argument to support it.

It is said that the receiver takes the estate subject to all the rights and equities of others existing at the time of the vesting of the estate in him. We believe, however, that this does not fully define the relation of the receiver to other persons under such circumstances.

Suppose it to be a case of insolvency. The insolvent may have entered into a contract by reason of which certain equities arose in favor of third persons, and this contract may have been in force or unperformed at the time of insolvency. Equities in favor of third persons depend for their preservation on the performance of the contract, or, possibly, on its not being violated by the doing of some act in conflict with it, which would destroy it. Should it be conceded that though the preservation of these equities depends upon the performance of the contract by the insolvent, the receiver might not be required to perform it in order to preserve it, and that whether he does so is left to him to determine — yet, conceding the soundness of this position, is the receiver so complete a stranger to the contract that he may not only refuse to carry out the same, but may take such action in respect to it as to constitute a violation of it, destroying the equities in question? When we speak of violation, we do not mean a mere breach of contract arising from failure to perform it, but we refer to doing something contrary to the contract, inconsistent with it, and contradictory of it.

Where the insolvent has conveyed an estate in land and, as a part of the contract of conveyance, has assumed and agreed to pay a mortgage thereon, though the estate may have passed from the hands of his vendee into those of a third person, yet he is prevented by his contract from paying this mortgage and taking an asignment of it and holding it as an encumbrance on the estate so conveyed a gainst the interests of his vendee and against the intervening equities of third persons. This would be a violation of the contract, not a mere refusal to carry it out, or his act might be construed as a performance of it and the relief be denied him.

When it is said that the receiver takes the property subject to all the rights and equities of others, does this legal conception embrace the idea that the receiver may not violate the existing contracts of the insolvent and seek a benefit therefrom, though they are not directly and immediately connected with any property that comes into his possession as receiver? Is the inability of the receiver to deal as he sees fit with those subjects concerning which the insolvent had made unperformed and binding contracts, limited only to those contracts which directly and immediately concern the property of the insolvent which comes into his hands and from which he derives a benefit and with which he is dealing? This seems to be the primary question involved. To state the proposition in another way:

On the receiver's appointment and his taking possession of the estate of the insolvent, does he become so much a stranger to those contracts and obligations of the insolvent which do not affect and relate to the property in his hands, that he can deal with them at will and violate them and disregard and annul them so as to benefit the estate in his hands — to the injury of the insolvent's vendee, and to the destruction of the rights and equities of third persons which attached to the property affected by the contract by virtue of the contract itself?

The purpose of violating the contract of the insolvent is to obtain some benefit and advantage against the estate conveyed by the insolvent, to which the contract related and by virtue of which it vested. Will equity permit the receiver under such circumstances to thus violate the contract and obtain such a benefit?

The situation presented here, however, is stronger than the one already suggested in this argument.

The Bank Supervisor claims to hold two mortgages on the estate in question, which passed to him from the insolvent, and it is for the protection of these mortgages that he seeks to obtain the advantage arising from an assignment of the Penn Mutual mortgage instead of a satisfaction of it. In other words, the Bank Supervisor has received these two mortgages as part of the estate of the bank, and the question is whether, under the facts in this case, he can be permitted to hold these mortgages free

from all equities of the vendee of the estate and the equities of third persons intervening. In dealing with these mortgages, is he not bound and affected by the equities of the bank in respect to the estate affected by them? It will be remembered that the existence of what is called the "purchase money mortgage," or the balance owing for the purchase money, is due to the very contract which the Bank Supervisor now seeks to abrogate and destroy.

Passing by the fact for the moment that the authority to purchase this mortgage was evidently obtained from the court, on the representation that it was obtained for the purpose of discharging it so that the property would not be charged with the tremendous expense of foreclosure, the question then assumes this form:

The Bank Supervisor, as a part of the estate of the bank, having acquired this mortgage, the very creation and existence of which involved the performance of the contract by the bank, can he now as the holder of this mortgage claim the benefit of it, seek to enforce it against the beneficiary of the contract and intervening equities which arose by virtue thereof, and annul, repudiate and violate the promise to pay the mortgage which was a part of the contract? We think these facts bring the Bank Supervisor clearly within the operation of the rule that he takes the property and estate of the bank subject to all the rights and equities of others which had attached in the hands of the bank. To permit

the Bank Supervisor, under such circumstances, to hold the purchase money mortgage as an asset of the estate and part of its property, and at the same time to repudiate the obligation of the bank on which it was based and by virtue of which it was created, would be a violation of every principle of equity and fair dealing.

THE SUPERVISOR OF BANKING MERELY THE REPRESENTATIVE OF THE BANK WITH ALL ITS BURDENS AND OBLIGATIONS.

At the trial of this case it was claimed that, by reason of the fact that the money used to pay the mortgage was the money of the depositors or the creditors of the bank, the rule applicable to receivers did not apply and that in any case it did not apply in the case of a bank.

It was not suggested that the money used by Duke was not the money of the bank or that it was not part of the estate in his hands for administration, nor was any reason suggested for the theory that a rule prevailed in the case of a bank, different from that prevailing in other cases.

There is no provision in our statutes that makes a distinction between depositors of a bank and other creditors. There is not even a distinction between contract debts and those arising in some other manner. From my examination of the question, I have found that in one or two states the claims of general

depositors have a preference over other claims, but this is by reason of a statutory provision. In the absence of such a provision, depositors are simple creditors. As a matter of fact the question has doubtless been before the legislatures of the different states, and we may take it for granted that it has been determined by them that there is no reason why the claim of a depositor should be held more sacred than the claim of any other creditor, and, as a matter of fact, we see none.

When acting within the scope of its powers, subject to the express limitations imposed on it by law, a bank is just like any other commercial or business organization, and its assets constitute its capital, to be handled and disposed of according to the will and judgment of its managers.

Subject to these qualifications, there is nothing that distinguishes a bank from any other commercial organization when it is considered with respect to its rights or its powers or its legal obligations. It has a full right to make and enforce contracts, and it is subject to the same responsibilities that are imposed by law on other corporations doing business. As a result, the winding up of a bank when it passes into the hands of a custodian provided by law for that purpose, takes place in exactly the same manner, from a legal standpoint, as in the case of other corporations, subject only to such modifications or changes as are provided for in the law regulating the subject. Both the text books and the au-

thorities unite in the declaration that, subject to these qualifications, the persons appointed by law to administer insolvent banks possess the same powers and the same duties as are given to or imposed on receivers for insolvent corporations. This is necessarily true, and in the case to which we have referred your Honor, *Moore v. Am. Sav. Bk. & T. Co.*, 111 Wash. 148, the Supreme Court of this state has practically established this proposition in construing our banking law.

Again and again it is announced by the courts that the bank receiver or supervisor, in the absence of any special provisions of a statute on the subject, is governed and controlled by the principles and rules of law applicable to receivers of insolvent corporations.

We desire to refer the court to the following cases directly sustaining this position::

Ward v. Oklahoma State Bank of Atoka, 151 Pac. 852. The court in this case sets forth the statute prescribing the manner in which the bank commissioner should wind up the affairs of the bank — and the provisions of the statute of Oklahoma are practically the same as ours. The court said:

"Considering the rights of the bank commissioner under the foregoing section, this court, speaking through Judge Brewer, in *Briscoe v. Hamer, et al.*, Sec. 4529, 150 Pac. 1101 (not yet officially reported), said:

" 'In this situation of the law, it seems to us that the position of the bank commissioner in taking charge and collecting the assets of a failed bank is quite analogous to that of a receiver or trustee in bankruptcy, or of an assignee for the benefit of creditors. As we understand the law, a receiver, an assignee, or a trustee in bankruptcy, takes the estate of an insolvent as he finds it, and succeeds to the rights of and only to such rights as the insolvent had at the time of the adjudication of his insolvency.'

"See, also, *Lawson v. Warren*, 34 Okl. 94, 124 Pac. 46, Ann. Cas. 1914-C, 139.

"Section 5234, R. S. U. S. (U. S. Comp. St. 1913, Sec. 9821), authorizing the appointment of a receiver for a national bank by the Controller of Currency, defines his rights and duties in language almost identical with that employed in our statutes, *supra*, relative to those of a bank commissioner. The Federal Supreme Court, in *Scott v. Armstrong*, 146 U. S. 499, 13 Sup. Ct. 148, 36 L. Ed. 1049, speaking of the rights of such receiver, said:

" 'The receiver took the assets of the Fidelity Bank as a mere trustee for creditors, and not for value and without notice, and, in the absence of a statute to the contrary, subject to all claims and defenses that might have been interposed as against the insolvent corporation before the liens of the United States and of the general creditors attached.'

"In *Peoples State Bank of Lakota v. Francis et al.*, 8. Md. 369, 79 N. W. 853, it is held:

" 'Where a receiver is placed in charge of the assets of a national bank, he stands, as to such assets, in the place of the bank, and is chargeable with knowledge of all facts known to the bank affecting the character of such assets.'

"Cases may arise in which the bank commissioner can assert rights that an insolvent bank of which he has taken possession could not enforce, but the instant case involved no such principle. The plaintiff bank acquired the note in question from the bank commissioner, who, as we have seen, was not a holder in due course, and its rights as purchaser and holder thereof are in no way superior to his.

"(2) By virtue of the statute above quoted, the bank commsisioner could sell the property of an insolvent bank, only upon order of the district court or the judge thereof. Such sale, like the sale of the property of an insolvent national bank by a receiver, is a judicial sale (*In re Third National Bank* (D. C.), 4 Fed. 775); and the purchaser of the commercial paper at a judicial sale is not regarded as a holder in due course (7 Cyc. 927, and cases cited)."

In *Briscoe v. Hamer*, 150 Pac. 1101, the court said:

"In this situation of the law, it seems to us that the position of the bank commissioner in taking charge and collecting the assets of a failed bank,

is quite analogous to that of a receiver or trustee in bankruptcy or an assignee for the benefit of creditors. As we understand the law, a receiver and assignee or trustee in bankruptcy takes the estate of an insolvent as he finds it and succeeds to the rights of and only to such rights as the insolvent had at the time of the adjudication of his insolvency."

The court thereupon proceeds to say that the right of set-off exists as against such a trustee. The court in this case quotes from the case of *Nix v. Ellis*, 45 S. E. 404, as follows:

"'Assignees, trustees in bankruptcy, and receivers, are not purchasers for value, and take the estate of the insolvent subject to all set-offs, liens and encumbrances, and in the plight existing at the date to which his title is ultimately referred'—citing numerous authorities."

Lawson v. Warren, 124 Pac. 46.

In this case there was a question arising on a conflict of interest between an assignee and a receiver, each of whom held a note secured by the same mortgage. A full discussion of the conditions attaching to an est ate, when it passes into the hands of an assignee or receiver, is found in this case. The court, among other things, said:

"We understand it to be the established doctrine, both in England and in this country, that assignees in insolvency or bankruptcy, whose rights as representing the general creditors are certainly as great

as those of a receiver of a partnership, in the absence of fraud and statutory regulations, take only the debtor's rights and consequently are affected with all claims, liens and equities which would affect the debtor if he himself were asserting his interest in the property."

Quoting from the case of *Miller v. Savage*, 60 N. J. Eq. 204, 4 Atl. 652, the court said:

"His (the receiver's) title to the property of the debtor is exactly the same as the title of the debtor himself at the moment when it goes into the receiver's hands."

A great mass of cases is cited to sustain this rule, and it is unnecessary for us to consider them further except the case of

Scott v. Armstrong, (U. S.) 36 L. Ed. 1059.

This case involved the question of set-off under the National Bank act. In this case it is said:

"It is insisted that the assets of the bank existing at the time of the act of insolvency included all its property without regard to any existing liens thereon or set-offs thereto. We do not regard this position as tenable. Undoubtedly, any disposition by a national bank, being insolvent or contemplative of insolvency, of its choses in action, securities, or other assets, made to prevent their application to the payment of its circulating notes, or to prefer one creditor to another, is forbidden; but liens, equities, or rights arising by express agreement, or implied from the nature of the dealings between the

parties, or by operation of law, prior to insolvency and not in contemplation thereof, are not invalidated."

In 5 Cyc., p. 560, the rule is stated as follows:

"The receiver represents both bank and creditors and can look behind its acts in asserting the rights they possess. He is entitled to the bank's assets subject to all the equities existing against them, but possesses no rights superior to the bank when it was alive."

The following cases also lay down the same rule with reference to receivers or supervisors of insolvent banks:

Commerce T. Co. v. State et al., 157 Pac. 717;
State v. City of Sapulpa et al., 160 Pac. 489;
Bailey v. State et al., 179 Pac. 615;
Cutler v. Fry, 240 Fed. 238;
Brady et al. v. Cobbs et al., 211 S. W. 802.

See also:

Jordan v. Harris, 135 S. W. 830;
Montgomery B. & T. Co. v. Walker, 61 So. 951.

It will be observed that in Oklahoma, although the bank commissioner acts, the actions are brought in the name of the state.

We submit to the court that no authorities can be found contradicting or controverting the rule stated by us and established by the foregoing cases, as well as numberless other cases. When the Bank Supervisor found himself in possession of the mort-

gage for six hundred thousand dollars and of the agreement to execute a second mortgage with bonds issued thereunder, to secure the payment of the purchase price of the lots in question, he elected to pay the Penn Mutual mortgage in order to protect the estate in his hands and to prevent a foreclosure of it.

It is fair, also, to presume that one of the purposes of the Bank Supervisor was to carry out the agreement to pay off the Penn Mutual mortgage, on the performance of which his right to claim the three hundred and fifty thousand, the purchase money of the lots, depended. The Bank Supervisor still claims the right to recover the three hundred and fifty thousand and stands before this court asking for a decree therefor, and at the same time he asks for a decree for the amount of the Penn Mutual mortgage, against which it warranted the title to the lots and which it assumed and agreed to pay as a part of the consideration for the payment by the building company, of the sum stated.

KNOWLEDGE BY THE BANK SUPERVISOR OF THE CONDITIONS AND CIRCUMSTANCES CONNECTED WITH THE WARRANTY AND THE ASSUMPTION BY THE BANK OF THE PAYMENT OF THE $70,000 MORTGAGE.

We think it is wholly immaterial whether the Bank Supervisor knew at the time he paid the $70,000 mortgage that its payment had been assumed by

the bank. We do not see how ignorance on his part, culpable or not, could affect the rights of other persons or destroy the equitable right of the building company and its privies to have the payment of the mortgage treated as a discharge of it. This question, however, is thoroughly discussed in the following case:

Peoples State Bank of Lakota v. Francis et al., 79 N. W. 853.

In this case the receiver granted an extension of a note. It appeared that one of the parties was a surety. The question arose whether this act of the receiver discharged the surety. The doctrine was invoked that the discharge of the surety does not take place except where it is made with knowledge of the relation of the parties. The court rejected this idea. The court used this language:

"Did the receiver stand in a better position? Appellant urges that the surety must affirmatively show knowledge of the suretyship on the part of the creditor who grants the extension in order to claim a release thereby. As a general proposition, that is doubtless correct, but it will be sufficient if the facts appear from which the law will presume such knowledge. Certainly, in this case, the receiver had not acted on the faith of the apparent character of Mrs. Francis as a principal within the meaning of our statute. That statute contemplates acting to his detriment, and operates by way of estoppel. It is urged that the receiver was not chargeable with the

knowledge of the facts that were known to the bank. This is an unwarranted contention. It would, we think, be a surprising holding to declare that a receiver of a bank could enforce all unmatured commercial paper that he found among the bank assets, irrespective of the equities existing against such paper. And yet that must logically follow, if the knowledge of the bank is not to be imputed to the receiver. The fact is, the receiver of a national bank is neither an indorsee nor an assignee for value. He is simply an agent and officer of the United States. *Ex parte Chetwood*, 165 U. S. 456, 17 Sup. Ct. 385, and cases cited. The government places him in charge of one of its financial agencies for the purpose of closing it up and terminating such agency, and in so doing he simply acts in lieu of the officers of the bank. He replaces them, stands in exactly their shoes, so far as the assets are concerned, and their knowledge necesarily becomes his knowledge. It follows, therefore, that whatever the receiver did, by way of extending time of payment, was done with full knowledge that Mrs. Francis was a surety only."

IN ANSWER:

On page 76 and the pages following of appellant's brief there is found an argument under the heading, "The Bank Commissioner was under no legal obligation to satisfy this mortgage and pay the debt and he could not legally do so"; and he also takes

the position that the funds were trust funds in the hands of the Bank Supervisor and that a resulting trust arose, etc.; and he again makes the statement in this argument that the bank was not under any obligation to pay the mortgage, which latter statement is, of course, wholly incorrect.

Counsel seems to be chiefly concerned with the proposition, that the satisfaction of this mortgage by the Bank Supervisor would have resulted in the preference of one class of creditors over another, and he cites cases involving this doctrine. These cases, however, have no application here.

The act of the Bank Supervisor, from any standpoint, was intended for the protection of the estate in his hands, and the persons incidentally benefited thereby were not creditors of the bank.

If the receiver of a corporation carries out a contract made by the corporation for the purpose of benefiting the estate, the mere fact that it might incidentally benefit someone else does not affect the question of his right to do the act or its validity when it is done. This is more like the situation presented in this case.

As to the proposition that the Bank Supervisor, who could not take an assignment of this mortgage and use it against the estate conveyed by the bank, yet when he used the funds of the estate to do so, a resulting trust arose in favor of the estate by reason of the alleged wrongful use of the funds, we have this to say:

Counsel does not cite a single authority to sustain this extraordinary proposition. If it be true that a resulting trust in this mortgage arose in favor of the Bank Supervisor for the benefit of his estate, it does not follow from this fact that this trust would overturn the equity of others of the lienors so as to entitle him to enforce the mortgage. If the mortgage, in which a resulting trust arose, is of no value unless it can be enforced, that is the misfortune of the Bank Supervisor, but I cannot imagine that a resulting trust could arise under such circumstances to overcome and destroy the equities of the lienors to which we have referred. There may be a trust in the mortgage, but the mortgage cannot be enforced. It may be a valid debt against the makers.

It must be borne in mind that the amount of this mortgage was included in the $350,000 to be paid by the building company for the lots. We have no idea that this proposition will be in any manner disputed, although in one part of appellant's brief he says that the property was well worth $350,000, which, of course, is incorrect. For fear that the matter may be disputed, we will state the following facts:

Mr. Pringle, who was president of the bank at the time lots 11 and 12 were bought, the building being on them, stated that the price was about $275,000 and that the bank paid about $210,000 in cash, leaving a mortgage for $65,000 on the property (Tr. 1129-32), and the mortgage now under considera-

tion is the successor of this mortgage. Drury conveyed lot 10 for $65,000, which the bank paid, and this sum was added on to the purchase price of the lots.

The figures don't fit exactly because, as stated by Mr. Larson, there were some items of interest, etc., involved in them. This made the cost of the entire property to the bank about $275,000, with the $70,000 mortgage added thereto, which made the $350,000 which the building company proposed to pay to the bank through bonds (Tr. 120).

There seems to have been some confusion in the minds of the subordinates in the bank as to what the equity of the bank in the original property was. (Tr. 1122-3, Tr. 1084).

The Bank Examiner or Supervisor kept insisting that the bank should show the amount of the mortgage as one of the liabilities of the bank, to offset the price at which the property was being carried (Tr. 1100). There seems to be considerable sensitiveness in the bank officials on this subject and, in order to avoid showing this mortgage as a liability, they actually obtained a release from the Penn Mutual of the bank from liability for this mortgage. The bank examiner counseled them to show the mortgage in their statements, and we refer the court to the statements in the transcript, as follows: 1084, 1102, 1104, 1237, 1242, 1244, 1246.

There can be no doubt whatever that in the $350,000 purchase price of the property the Penn Mutual

mortgage was embraced, and this is the sum for which appellant seeks to enforce a purchase money lien in this action. There can, of course, be no question that as a part of the promise to pay $350,000 for the lots the bank assumed the mortgage.

We believe it should not be questioned that, if Duke had taken this money and with it had deliberately paid and discharged the mortgage for the protection of the estate, his act would have been unimpeachable and no claim could have been made that an equity or right of subrogation to the rights of the mortgagee arose from the transaction, in his favor, for the benefit of the creditors or depositors. Such an act would have been strictly within the limits of his duty to protect the est ate in his hands by paying off an encumbrance prior to the Simpson mortgage and the purchase money lien, and by saving it from the dangers arising against it by reason of the breach of its warranty of the title to the real estate. If he could do this, it is simply because the money is in his hands, subject to be properly used in the administration of the estate. It is not the money of the creditors or the depositors; it belongs to the estate, to be used as the balance of the estate is subject to use, for its benefit, but not subject to use in violation of the rights and equities of others which had attached while the estate was in the hands of the bank.

While, speaking in general terms, the Bank Supervisor might not be compelled to carry out a con-

tract of the bank, unwise or unprofitable in his judgment, for the mere purpose of protecting these equities, yet the law declares that these equities, so far as the bank and he are concerned, are inviolate, and any act of his disregarding or doing violence to them must fail in its purpose. Having done such an act, he cannot call on a court to aid him in rendering it effective. He cannot say:

"I know I had no right to do this but I did it, and having done it, what are you going to do about it? If the court refuses to aid me in enforcing the mortgage, the depositors and creditors will suffer. Therefore, in their behalf, my wrongful act must be enforced, in my name, for their protection, notwithstanding the fact that what I did was done by means of and through the agency of the estate in my hands for administration. I will not stand by and permit the mortgage to be foreclosed and the estate and the rights in my hands to be jeopardized or impaired in this way, or subjected to a claim for damages for a breach of the warranty. I think the wisest course would be for me to buy this mortgage with the funds of the estate and enforce it myself, and myself inflict the damages arising from its foreclosure, on the estate I represent."

Thus he could, as appellant claims, without any responsibility, use the funds of the estate to violate the contract of the bank and injure the estate itself by subjecting it to damages; and, when his right to do this is denied, he could answer, "This is the money of the depositors and creditors. They are not

concerned with the contracts of the bank. By the insolvency of the bank, its estate became disentangled from its contracts and became the absolute property of the depositors and creditors, to be administered for their exclusive benefit, unhampered by any equities or rights that the bank may have created by its contracts."

In view of the authorities cited by us, the mere statement of this proposition is an answer to it.

In one case we read while writing this brief, which we have not been able to find again, the court said that if the insolvency of a corporation had the effect of altering, destroying or affecting the existing rights and equities of others, its utility and value as an instrument for the transaction of business would be destroyed; that no one would do business with an institution, the validity and enforceability of whose contracts depended on the continuance of its solvency.

There can be no question that when the mortgage was purchased by Duke, it inured under the warranty, to the benefit of the building company, and those in priority with it, the lienors.

While writing this brief our attention has been called to the brief of Tacoma Mill Work & Supply Co. at the bottom of page 92 and the pages following.

Counsel refers to the pages of the *transcript of the testimony*, which is not before the court. We think the substance of the testimony to which he refers is found in the *transcript of the record at* pages 1122-1123.

THE SIMPSON MORTGAGE FOR $600,000, THE PURPOSE OF WHICH HAVING FAILED, WAS THEN, FOR PRUDENCE AND CONVENIENCE, ASSIGNED TO THE BANK. ITS ENFORCEMENT HERE.

Though it may be repetition, we will again refer the court to the pages of the transcript containing the evidence necessary to the determination of the question of the enforcement of this mortgage.

Simpson executed a declaration of trust, declaring that he held the mortgage in trust for the building company to raise funds which were to be the property of the building company. It is specific and exclusive in its declarations. (Transcript 1010).

The mortgage was not given to secure future or existing advances by the bank. (Transcript 1018-19, 1047, 1051).

The assignment of the mortgage was not made to secure the bank, but was prompted by considerations of prudence and convenience. (Transcript 1048, 1051, 1085, 1033).

The bank bought the stock of the building company with the $200,000 placed to the credit of the building company. It was not an advance by the bank to the building company. (Transcript 1026-7, 1032-3-4, 1097, 1119).

The payment of the purchase price of the lots was not secured or intended to be secured by this mortgage. It was to be paid by bonds issued under the

second or $750,000 mortgage. (Transcript 120, 1017, 1106, 1123, 1129-1132, 1237).

Although the facts clearly demonstrate that the assignment of this mortgage was not made as collateral security, yet Duke claims that it was and has sought to enforce it accordingly.

Answering this position, we desire to say:

We will not enter into an elaborate discussion of the proposition that Simpson, holding the mortgage as trustee of an express trust, had no power to assign it to the bank, contrary to the terms of his declaration of trust, as collateral security or for any other purpose. The act was void. We think this is elementary.

If the assignment was valid for the purpose of merely passing the title, the evidence shows that no subsequent act of the building company devoted or applied it to the purpose for which certain officers of the bank subsequently sought to hold it. There was no act on the part of the building company or its officers diverting it from the purpose for which it was given, or definitely applying it to a purpose that was not in harmony with the object of its creation, but which, on the contrary, was in conflict therewith. We believe the mortgage could not be used. It became a nullity when its purpose failed. We believe the act of some officers of the bank in subsequently declaring this purpose, or in even conceiving or carrying it out, if they did it, could not give it life.

The assignment was not made until October 7, 1920. At that time the Far West Clay Company, Savage-Scofield Company and the other lienors furnishing builders' materials had already made their contracts therefor and had begun to furnish the same under entire contracts. It is the established rule that even if the assignment of the mortgage, as collateral security, was valid, the lien of the mortgage did not accrue before the time when the assignment was made, if it accrued then, and it is therefore subsequent to these liens.

Under our statute, mechanics' liens are preferred to any lien or mortgage which may *attach* subsequently to the time of the commencement of the performance of the labor or the furnishing of the materials, and are also preferred to any lien or mortgage which may have attached previously to that time but which was not filed or recorded and of which the lien claimant had no notice.

2 Rem. & Bal. Code, Sec. 1132.

The statute makes a clear distinction between mortgages which had not attached at the time of the furnishing of the labor or materials, and those which had attached but which had not been recorded and of which the mechanic or materialman had no notice. It is clear from a reading of the statute that the primary test of priority is the attaching of the mortgage or incumbrance. The secondary test is the recording of it after it has attached or notice of it after it has attached. The primary

question, therefore, is: "When does a mortgage attach?" Several situations of the parties which affect this question readily suggest themselves. It is an elementary rule of law that an instrument does not take effect until delivered. It cannot, of course, attach prior to delivery for the purpose of taking effect. The word "attach", as used in this connection, has a definite legal signification. It means that the instrument has taken effect in such manner as to then and there confer upon the person to whom it is made or delivered certain fixed and definite rights. This implies that these rights are of such a character as that they may be claimed or enforced against the rights of others subsequently arising which conflict therewith. The conception of priority in legal rights involves the idea of some substantial basis upon which they rest, either a present consideration or the assumption of a present duty or obligation, binding upon the party assuming the same.

A mortgage may be executed and delivered which secures a sum of money to be advanced in the future, where the obligation to advance the money is a fixed and binding one, and the instrument will be treated as attaching from the time of delivery, although under crtain circumstances its operation as a prior lien may be arrested by the intervention of equities arising under various circumstances and conditions. It is, however, essential to the existence of the mortgage or encumbrance as a prior right that it should

attach at some definite time. If the money secured by the mortgage is advanced at the time, the mortgage attaches from that time.

In this case, the mortgage was executed and delivered to Simpson and was recorded. Simpson paid nothing nor did he bind himself to make any payment. He took the mortgage for the purpose of selling it in the open market. This mortgage, therefore, did not attach until some one bought it or entered into a valid and binding contract to advance the money thereunder.

The authorities are unanimous to the effect that a mortgage, issued under the circumstances shown in this case, does not attach until it has been delivered to some one who has paid the money therefor, or who has taken it and entered into a valid and enforcible contract to advance the money therefor.

In the case of *Schafer v. Reilly*, 50 N. Y. 61, the mortgage was executed, delivered and recorded. It was payable to one who advanced no money on account of it and who merely took it for the purpose of negotiating the sale. At a subsequent time, it was sold to a *bona fide* purchaser without notice, this purchaser taking the precaution to require from the holder of the mortgage an affidavit that all the money secured thereby had been advanced and paid. Prior to the time of the purchase of the mortgage, mechanics' liens had entered in. In a well considered opinion, the court held that the liens took priority over the mortgage; that the mortgage had not

attached until it had been sold to the purchaser, who paid a consideration therefor, and that the liens therefore had accrued prior to the time when the mortgage attached.

It will be observed in this case that, unlike the case at bar, the purchaser had no notice of the facts. In the case at bar, the bank, at the time it advanced its money and at the time it took the assignment, had full notice that no consideration had been paid for the mortgage, and that it had therefore not attached and that liens in the meantime had accrued.

See, also,

Hewson-Herzog Sup. Co. v. Cook, 54 N. W. 751;

Finlayson v. Crooks, 49 N. W. 398, 645;

Blackmauer v. Sharp, 50 Atl. 852 (See discussion on page 858 Col. 2);

27 Cyc. 239-40.

Where lien attaches in part, prior to mortgage, the labor and supplies furnished afterwards in continuation of contract have also priority.

27 Cyc. 247 (4).

It is perfectly clear that the Simpson mortgage was never assigned to the bank as security and that at the time it was made it was not so intended.

If it was assigned to the bank as security, in October, 1920, the lienors furnishing builders' materials had already begun to furnish them under their contracts, and the mortgage was subsequent

thereto under our statute referred to, and under our decisions, and their future advance of builders' materials, under their contracts, would take precedence over future advances made by the bank.

This question is more fully discussed in the brief of Hayden, Langhorne & Metzger and the desire to adopt the arguments on the subject therein contained.

BANK ESTOPPED TO ASSERT MORTGAGE.

It appears that the officers of the bank and the building company represented to many of the materialmen, and caused it to be generally understood, that the money to build the building had been arranged for. We know that the Simpson mortgage, to be floated in the East, was one of the chief sources of money which the bank had in mind in making these representations, and that these materialmen relied on these representations. That they were untrue may be treated as established.

Will equity permit the bank to take this mortgage, hold it as security for its advances, and obtain priority over the liens of these materialmen? The court below in his opinion held otherwise.

It was said that no equity arises in favor of these materialmen because it makes no practical difference to them that the mortgage is held as security for money advanced by the bank, instead of being held by others for money advanced by them. This proposition is not sound. If the mortgage had been floated, the lienors themselves would have been paid

in part or in whole. In such event they would have received the benefit of the money directly. It will be remembered that there was little or nothing due the bank when the assignment was made to it. The builders' materials were partly furnished. Would the bank be permitted, after the failure of its scheme, to take this mortgage and claim such a preference over these lienors?

Will not the court decree that the mortgage, having been made to procure a fund for their benefit, can not now be diverted by the bank so as to give it a preference and that the fund, not having been procured so that the money can be so applied, the mortgage, if valid for any purpose in the hands of the bank, will be assigned to a position of inferiority to the claims of these lienors. We think this is equity and justice.

FOR THE BANK TO HOLD THE SIMPSON MORTGAGE AND ENFORCE IT BY VIRTUE OF THE ASSIGNMENT, AS COLLATERAL SECURITY FOR A PRE-EXISTING DEBT, IS CONTRARY TO THE PROVISIONS OF THE CONSTITUION OF THE STATE OF WASHINGTON.

The Constitution of the State of Washington provides . . . "Nor shall any corporation issue any bond or other obligation for the payment of money except for money or property received or labor done. All fictitious increase of stock or indebtedness shall be void." (Const. Washington, Art. 12, Par. 6).

It is generally held by the courts that provisions in the Constitution, similar to the one referred to above, should be strictly construed, according to the purpose and design of the framers of the Constitution. Accordingly, it is said by the courts that the pledge by a corporation of its obligations to pay a pre-existing debt is void, because it is in conflict with this provision. The courts say that the purpose of the provision was to prohibit a fictitious increase of its indebtedness; that it was to prevent an increase of indebtednes without any *present* consideration being paid therefor.

In the case of *Farmers Loan & Trust Co. v. San Diego St. Car Co.*, 45 Fed. 518, the bonds of the railroad were authorized for a specific purpose. They were issued but never sold for this purpose, and afterwards they were pledged to secure an antecedent indebtedness. Under the provisions of the Constitution of California, similar to the one in the Washington Constitution, it was held that this pledge was void and that the bonds could not be held for the purpose for which they were pledged.

The court used this language:

"This constitutional and statutory inhibition is plain, and has but one meaning: the money paid, labor done, or property actually received must be paid, performed, or received, as the case may be, on account of the issuance of the bonds; and any bonds issued contrary to this provision are, of course, illegally issued. The provision does not mean, and

cannot be held to mean, that such bonds may be issued as collateral security for any sort of pre-existing indebtedness."

The opinion was delivered by Judge Ross.

In the case of *Kemmerrer et al. vs. St. Louis Blast Furnace Co. et al.*, 212 Fed. 63, the language of the Constitution, under consideration, was practically the same as that of the Constitution of the State of Washington. The same conclusion was reached in that case. In it the court cited with aprpoval the decision in the *Farmres Trust Company* case, above referred to.

It contains a review and a critical consideration of all the cases bearing on this question, and, after making a careful analysis of the cases, the court said:

"We have examined all the cases cited by counsel and have examined all others which we have been able to find; and, with the exception of *Nelson v. Hubbard, supra*, we find the whole trend of authorities supports the proposition that there must be a present consideration, in order to satisfy the demand of such constitutional and statutory provisions as are herein involved. Any other construction simply fritters away the safeguards which the Legislature sought to throw around the creation of corporate indebtedness."

To the same effect see *Memphis R. R. Co. v. Dow*, 120 U. S. 287; 30 L. Ed. 595.

In the case of *In re Progressive Wall Paper Corp.*, 224 Fed. 143, the referee made a report holding that certain bonds or obligations which were pledged as security for a pre-existing debt were void in the hands of the pledgee. The court reversed this decision, and, while other questions were involved, it practically refused to follow the cases to which we have referred.

On appeal, the decision of the court was reversed in the case of

In re Progressive Wall Paper Corp., 229 Fed. 489.

In this case the Circuit Court of Appeals reviewed all the cases and confirmed the doctrine for which we contend, and held that the pledge of the securities was void and sustained the decision of the referee.

Under the existing circumstances we are not disposed to enter into any discussion of these cases, or the doctrine announced by them, at this time. They fully and amply sustain our position and we feel that any argument that we might make on the subject would be but a weak repetition of the arguments stated in the cases themselves. It is, therefore, we think, unnecessary for us to further discuss this question.

On pages 143-4 of his brief, appellant quotes largely from the decision in the *Progressive Wall Paper Case* in 224 F. 1434, apparently oblivious to the fact that that decision was reversed by the Circuit Court of Appeals, as shown above.

The decision was quite unsound and deserved a reversal. It seems to have largely turned on the fact that one of the endorsers on the original note was released from the new note secured by the bonds or mortgage, and that this was a *present* consideration—it proceeded on false assumption in other respects.

In respect to both of these mortgages it may be said that, as a matter of fact, the two corporations, the bank and the building company, were the same; the building company was the mere agent of the bank, created for the purpose of effectuating a purpose in violation of the banking laws of the State of Washington.

In effect, when the bank sold the property to the building company it was a sale to itself, and when it took the assignment of the Simpson mortgage it was in effect taking a mortgage of its own property. When the Supervisor of Banking bought the $70,000 mortgage, he was in fact buying a mortgage which was in fact the debt of his principal and a mortgage which was on the estate which in fact still belonged to it. Under these circumstances, we think, the Bank Supervisor could not hold either of these mortgages.

On the question of the identity of the corporations, we desire to refer the court to the argument of Messrs. Stiles & Latcham in the brief filed by them on behalf of Ben Olson, appellant, which is an able and exhaustive argument on the subject. We desire

to adopt the argument of these appellants on this question.

PURCHASE MONEY LIEN.

On page 157 of appellant's brief he apparently contends that the bank was entitled to a lien for the purchase money of the property and that the commissioner of banking is entitled to enforce it in this suit.

There was no express lien for the purchase money reserved in the deed or in any other writing. There was no agreement to this effect. The lots were to be paid for by bonds to be issued under the $750,000 mortgage, which was to be given at some later date. It is well established in the State of Washington that a purchase money lien cannot arise in this way.

Smith vs. Allen, 18 Wash. 1;
Hill Estate vs. Whittlesey, 21 Wash. 142.

In the first case above mentioned the court points out the history of the doctrine with reference to purchase money liens in England and declares that this doctrine does not prevail in this state. The language of the court settles the question in the State of Washington. It is pointed out in this decision that the doctrine of the vendor's lien has never been affirmed by the Supreme Court of the United States except where it is established by the local law.

See *Bailey vs. Greenleaf*, 7 Wheat. 46;
Ahrend vs. Odiorne, 118 Mass. 261, S. C. 19 Am. Reports 449.

The agreement for the giving of the bonds under the $750,000 mortgage was not signed by the parties and was not recorded, and it is not contended that any of the parties to this suit had notice of it. It was a secret lien in conflict with the registry laws of the State of Washington.

2 Rem. Bal. Code, 874-5-6;
Bell vs. Swalwell, 20 Wash. 602-4.

It is expressly laid down that the taking of a mortgage as security for the unpaid purchase money waives the vendor's lien.

2 Jones on Liens, 3rd Edition 1086-7 (Cases cited);
Hunt vs. Waterman, 12 Cal. 801;
Avery vs. Clark, 25 Cal. 919;
Mason vs. Daily, 44 Atl. 839;
Ledos vs. Kupfriar, 28 N. J. Eq. 161;
Robbins vs. Mastella, 46 N. E. 330;
Blomstrong vs. Due, 51 N. E. 755.

If the mortgage securing the purchase money is not given at the time of the conveyance but is subsequently given, yet intervening liens will attach and have priority.

See 25 Cyc. 250 for a full discussion of the question.

Osborne vs. Barnes, 61 N. E. 276;
Saunders vs. Penny, 35 N. E. 111, S. C. 39 Am. St. Reports, 456;
Ansley vs. Pasahro, 35 N. W. 885.

The bank is estopped from claiming the right of a preferred lien under its agreement, by reason of certain considerations of equity. At the time the land was sold to the building company, this company, with the knowledge, consent and connivance of the bank, entered into building contracts for the construction of a building on the premises, and the lienors, claiming liens in this suit, proceeded to furnish labor and materials for the erection thereof. The bank encouraged and promoted the furnishing of the materials and labor, although it was well aware of the fact that the mortgage had not been executed or recorded. It gave no notice to anyone that it claimed a lien for the purchase money, nor did it give any notice of the agreement with respect thereto. The bank not only encouraged the construction of the building, but its president demanded that the contractors and others waive their right of lien and promised that mortgages, which could not be placed if there were liens on the property, would produce the money needed to pay all liabilities to them. Having thus remained quiet, and encouraged and permitted defendants to expend their labor and material in the construction of the building, it is now estopped from claiming any priority on account of the executory agreement for the mortgage.

This question is practically settled by our own Supreme Court.

Bell vs. Swalwell Land, etc., Co., 20 Wash 602.

The court said that the purchase money lien was

a secret one, and that the liens would take precedence over it because it had not been recorded.

We think that the judgment of the court below was right in every respect, and that neither of the mortgages or the purchase money lien is entitled to recognition in a court of equity.

Respectfully submitted,

R. S. HOLT,

FITCH & ARNTSON,

Counsel for Far West Clay Company, Savage Scofield Company and other Appellees.